IN THE

Supreme Court of the United States

OCTOBER TERM, 1938.

No. 509.

DENIS J. DRISCOLL, THOMAS C. BUCHANAN, DONALD M. LIVINGSTON, RICHARD J. BEAMISH AND JOHN SULLIVAN, INDIVIDUALLY, AND AS THE PERSONS CONSTITUTING THE PENNSYLVANIA PUBLIC UTILITY COMMISSION,

AND

UTILITY CONSUMERS LEAGUE OF YORK, PA.,

Appellants,

v.

EDISON LIGHT & POWER COMPANY,

Appellee.

APPELLEE'S BRIEF.

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APPELLEE'S BRIEF.

HISTORY OF THE CASE.

The Appellee is a public utility corporation organized under the laws of the Commonwealth of Pennsylvania and is now and for many years has been engaged in the business of generating, transmitting, distributing and selling electric energy in and about the

City of York in the Commonwealth of Pennsylvania. The Appellee was originally organized through the merger and consolidation of several public utility corporations, as a wholly owned subsidiary of York Railways Company, likewise a Pennsylvania public utility corporation engaged in operating certain traction properties in and about the City of York and its environs. York Railways Company has since that time owned and now owns all of the stock, as well as certain unsecured indebtedness, of the Appellee. All of these holdings are pledged as collateral security under an Indenture of Trust between York Railways Company and The Tradesmen's National Bank and Trust Company, pursuant to which the bonds of York Railways Company were issued. There were originally issued $6,116,000.00 principal amount of these bonds, of which approximately $5,000,000 principal amount are presently outstanding.

On January 27, 1936, the Pennsylvania Public Service Commission, the predecessor of the Appellants constituting the Pennsylvania Public Utility Commission (hereinafter sometimes referred to as the "Commission"), instituted on its own motion an inquiry and investigation for the purpose of determining the reasonableness of the rates charged by the Appellee for the electric service rendered by it. Numerous hearings were held before the Public Service Commission and before the Appellants. During the course of these hearings the Appellee introduced complete and comprehensive testimony and exhibits in proof of (i) the fair value of the property devoted by it to the rendition of its public service, (ii) the fair return which the Appellee should be permitted to earn upon such fair value, and (iii) the reasonable and necessary allowances which

should be made for the operating expenses of the Appellee in determining the rates necessary to provide such a fair return. Testimony and exhibits were likewise introduced on behalf of the Public Service Commission and its successor, the Public Utility Commission. The entire proceeding was completed on June 23, 1937.

On that date, immediately following the conclusion of the final rate hearing, and pursuant to notice of June 15, 1937, a hearing was held to determine whether temporary rates should be prescribed. The entire record in the proceeding to fix permanent rates was incorporated as a part of the temporary rate proceeding. Oral argument was waived by the Appellee. At that time nothing remained to be done to conclude the proceeding except the filing of briefs if, as and when requested by the Commission. This situation has obtained since June 23, 1937, and *since that time the Commission has at all times had before it the evidence upon which it might fix, determine and prescribe final and permanent rates.*

Despite the fact that all evidence necessary to a determination of permanent rates was before the Commission on June 23, 1937, and despite the obvious lack of necessity for the prescription of temporary rates, the Commission made no effort whatever to fix and determine final and permanent rates. On the contrary, on July 13, 1937, the Commission entered an order directing the Appellee to file temporary rate schedules effecting a reduction in annual gross operating revenues of approximately $435,000. On July 27, 1937, a second order was entered by the Commission which, by its express terms, rescinded the previous order of July 13th, but prescribed an identical temporary rate reduction of

approximately $435,000 in gross operating revenues. The enforcement of this order and the rates which it prescribed was permanently enjoined by a statutory court convened in the Middle District of Pennsylvania by order dated October 15, 1937 (21 Fed. Supp. 1). No appeal was taken by the Commission from that decision.

Thereafter, on November 17, 1937, because of intervening changes in circumstances of the Appellee, additional evidence, designed to bring the evidence before the Commission up to date, was stipulated into the record. The Appellee waived its right to file briefs. *Once again the Commission was in possession of all of the evidence which it needed to fix, determine and prescribe final and permanent rates.* Nothing whatever remained to be done by the Commission except to consider the record before it and to prescribe permanent rates. This would not have been a very lengthy process. Indeed, as early as August 2, 1937, counsel for the Commission stated in open court before the statutory court convened in the Middle District of Pennsylvania that the Commission could fix permanent rates within a period of two-and-one-half-months. Moreover, it is manifest from a reading of the Commission's report and order that it considered the record before it in detail and without any additional effort could have made a final order fixing and determining permanent rates.

Notwithstanding these facts, the Commission made no effort to fix and determine final and permanent rates. Once again, on December 7, 1937, the Appellee was served with a copy of an order issued by the Commission dated November 30, 1937, prescribing temporary rates for the Appellee identical with those fixed and determined in

the previously enjoined order of the Commission dated July 27, 1937. This new order likewise effected a reduction of $435,000 in the gross annual operating revenues of the Appellee. Thus for the third time the Commission entered an order prescribing temporary rates and effecting exactly the same reduction in revenues imposed in the two earlier orders. The reasons assigned in two of the opinions and orders (the first assigned none) were different, but the answer was the same in all three instances.

On December 14, 1937, the Appellee filed its bill of complaint in the United States District Court for the Eastern District of Pennsylvania to enjoin the Appellants' order of November 30, 1937. A statutory three-judge court was convened, pursuant to the provisions of Section 266 of the Judicial Code, as amended, and after due notice the matter came on for hearing on January 17, 1938, on the Appellee's motion for an interlocutory injunction. On February 15, 1938, it was stipulated by the parties that the matter be treated and decided by the court as an application for a permanent injunction. On October 10, 1938, the court below filed its opinion granting a permanent injunction restraining the Commission from enforcing the temporary rates prescribed in its order of November 30, 1937 (25 Fed. Supp. 192). A final decree in accordance with this opinion was entered on October 14, 1938, from which decree the Appellants now appeal.

The foregoing review abundantly demonstrates that the present case is not one where a temporary rate order was required in the public interest or necessary for the purpose of protecting consumers during the pendency of

a long and involved rate proceeding. The proceeding itself was concluded before the entry of the first temporary rate order, since which time two additional temporary rate orders have been imposed. And this despite the fact that counsel for the Commission stated in open court on August 2, 1937 that a final determination of rates could be made within *two-and-one-half months*, or by the middle of October, 1937.

At the present time, over a year-and-one-half has elapsed since the conclusion of testimony on June 23, 1937. Nearly a year-and-one-half has elapsed since counsel for the Commission stated that a final determination could be made within two-and-one-half-months. Well over a year has elapsed since the Commission was permanently enjoined from enforcing its second temporary order prescribing rates identical to those now attempted to be enforced. Clearly, then, we are not faced with a practical situation involving the necessity of balancing the interest of consumers and investors. *We are, however, directly faced with the converse and equally practical question, namely, whether the Commission can, under the cloak of a so-called temporary rate statute, completely disregard its duty to prescribe final and permanent rates and succeed in enforcing so-called temporary rates upon which no time limit has been placed, regardless of the effect of such rates upon the operations of the Appellee and of the legality of the methods employed by the Commission in arriving at its conclusion.*

STATEMENT OF FACTS.

The Commission's Order of November 30, 1937 is a supplemental temporary rate order (R. 15-39). In it the Commission reviews the record before it, sets forth certain findings, and comes to certain conclusions concerning (i) the rate base of the Appellee, (ii) the allowable rate of return, and (iii) the operating expenses which should be allowed in determining the gross revenues to which the Appellee is entitled. In this order the Commission found that the reproduction cost new of the Appellee's property as of the date of the order was $5,293,664.00, that the depreciated reproduction cost was $4,737,803.00, (R. 28) that the original cost was $4,576,169.73, and that the depreciated original cost was $4,094,000.00 (R. 29). The Commission found that a reasonable allowance for working capital was $164,000.00.

On the basis of these findings, and without making any specific allowance for going concern value, the Commission found that, for the purpose of fixing temporary rates, the value of the Appellee's property was $5,250,000.00. To this rate base the Commission applied an arbitrary rate of return of 6%.

The Commission in its paid order considered the operating expenses of the Appellee and disallowed for rate making purposes (1) rate case expense actually incurred in the amount of $178,374.50, (2) salary expense actually to be incurred in the amount of $20,593.00 and (3) a loss in net operating revenues in the amount of $15,000 which would, by reason of the discontinuance of the trolley operations of York Railways Company, necessarily result.

The Commission reached the conclusion that the annual allowances for operating expenses, depreciation

and a return of 6% upon $5,250,000.00 totaled $1,697,829.00, and prescribed temporary rates to effect a reduction of $435,000.00 in gross operating revenues.

The foregoing findings and conclusions of the Commission purport to be based on the evidence introduced into evidence by the Appellee and the Commission.

At the hearings before the Public Service Commission, the Appellee, in order to present to the Commission and its predecessor a complete and accurate basis for determining the fair value of the property devoted by it to the rendition of its public service, retained Day & Zimmermann, Inc., internationally known public utility engineers and consultants, to make estimates of the reproduction cost new, depreciated reproduction cost, and original cost of such property, and to determine its fair value.

The estimates of reproduction cost and original cost of the Appellee's property, introduced in evidence before the Commission (Appellee's Exhibits 9 and 18 R. 1021, 1030), were made under the personal direction of Mr. Theodore E. Seelye, vice president of Day & Zimmermann, Inc. His testimony before the Commission not only fully qualified him as an expert engineer but one completely conversant with the problems of appraising, constructing and operating public utility properties. His qualifications were conceded by counsel to the Commission.

The analysis of the business, properties and affairs of the Appellee and its affiliated corporations which was necessary in order to complete the investigation required by the Commission and its predecessor covered

a period of approximately eight months, and required the services of a considerable number of members of the staff of Day & Zimmermann, Inc.

Reproduction Cost.

Appellee's reproduction cost estimate analyzes in detail the property and general overhead accounts, and the means by which the reproduction cost new of its property used and useful in the public service as of November 30, 1936, was estimated at $5,572,134 (R. 629). It also indicated such reproduction cost less accrued depreciation as $4,950,609 (R. 629).

In arriving at these figures, a complete inventory of Appellee's property was made by a physical examination and count in the field of the actual units of property in place, which were then classified in accordance with the appropriate account numbers or classifications designated by the Uniform Classification of Accounts prescribed by the Commission. The present construction cost of the physical property was estimated by obtaining actual quotations from manufacturers of and dealers in the materials required to construct the property set forth in the aforementioned inventory, and by adopting the prevailing rates paid to labor in the City of York of the required character or degree of skill. Quotations from manufacturers and dealers were based upon actual competitive prevailing market prices, and reflected any discount to which the Appellee would be entitled for purchasing in quantity amounts (R. 492-493, 504-512, 517-527, 544-548).

Subsequently the estimates of reproduction cost new and depreciated were translated into prices prevailing on or about June 1, 1937, to show the extent to which the original estimates had been affected by actual rising

prices between November 30, 1936, and a date more nearly coincident with the termination of the rate proceedings. The estimate of reproduction cost new, as of June 1, 1937, was $6,019,832, and depreciated reproduction cost approximately $5,350,000 (Appellee's Exhibit 18, R. 911).

All of the foregoing estimates were based upon an inventory of the Appellee's property as of November 30, 1936. It was stipulated of record that the net additions to its property from November 30, 1936, to September 30, 1937, totalled $142,851.07 (Appellee's Exhibit 22, R. 1037-1038).

Depreciation was determined by personal inspection of the various units of property by a number of expert engineers who considered, among other things, the physical condition of the units, the approximate dates of installation, the manner in which the units had been maintained, the degree of obsolescence, and the adequacy or inadequacy of each particular unit (R. 496-497).

The Commission introduced no substantial evidence of reproduction cost. *The only engineer who testified for the Commission in connection with reproduction cost admitted that he had made no physical inspection of the Appellee's property and that he had not formed an independent judgment as to the reproduction cost, new or depreciated, of such property* (R. 457, 958).

Certain exhibits were offered on behalf of the Commission purporting to be estimates of the reproduction cost, new and depreciated, of the Appellee's property (Commission's Exhibit 17 Revised and 21 Revised, R. 990A, 989).

The Commission offered its Exhibit 21 Revised (R. 990A) which was based entirely upon the Appellee's

reproduction cost appraisal as of November 30, 1936, adjusted to exclude certain property of the Appellee and to reduce the general overhead accounts.

Appellee's witness Seelye testified that, in fixing an allowance for general overheads, he made an actual inventory and appraisal of the physical property of Appellee, including an investigation and study in the field of all the elements necessary to arrive at a mature and deliberate judgment (R. 551-566).

Commission's witness Bierman testified **that he had not made a physical examination or inspection of Appellee's property, that he had not formed an independent judgment of its reproduction cost new**; that he had accepted Appellee's appraisal as to direct cost of its property and had made certain adjustments in overheads (R. 457, 959).

The Commission introduced *no evidence whatsoever* as to the reproduction cost of Appellee's property as of June 1, 1937 and *no independent evidence* of the reproduction cost of such property as of any other date.

Original Cost.

Appellee's Exhibit 9 before the Commission, classified by property accounts in a form similar to that of the reproduction cost estimate, contains an estimate of the original cost of Appellee's property used and useful in its public service as of November 30, 1936, in the sum of $4,969,000 (R. 791). Net additions to September 30, 1937 increase this estimate to $5,111,851.07 (R. 1037, 1038).

In determining the foregoing estimate of original cost, the actual costs of materials and labor to Appellee or its predecessors, as of the respective dates of installation or construction were adopted, and these costs were ap-

plied to the aforementioned inventory as of November 30, 1936. In cases where the books of the Appellee failed to disclose actual cost, prevailing prices of materials as of the dates of installation or construction, and prevailing costs of labor in York, Pennsylvania, as of such dates, were applied (R. 632-637).

Commission's Exhibits 23, 26 and 27 purported to show the original cost of respondent's property as $4,382,647 (R. 990, 994, 998). With respect to the sources of these exhibits, the Commission's witness, McShea, testified (R. 402-413) that from one-third or one-fourth of the information respecting the property described in his purported estimate of original cost was obtained from capital stock tax returns of predecessor companies of the Appellee and the books of such predecessor companies containing entries made prior to the year 1913; that he had not considered certain items appearing on the books of such predecessor companies; that a large part of the property referred to in such purported estimate was no longer in existence; that such purported estimate did not take into consideration the property of the Appellee now used and useful in the public service; that no consideration was given to the net additions of approximately $70,000 from November 30, 1936, to June 30, 1937; that such purported estimate was made without regard to whether the property therein referred to was devoted to the rendition of the Appellee's public service; that some of his estimates were judgment figures; *and that he had no way of knowing whether the figures contained in the tax returns and books of predecessor companies of Appellee were recorded thereon at original cost or r. l.*

In its order complained of, dated November 30, 1937, the Commission made adjustments to include net addi-

tions and construction work in progress during 1936 and arrived at a figure of $4,576,169.73 as the original cost of Appellee's property as of December 31, 1936 (R. 21). It introduced no evidence whatsoever of the original cost of Appellee's used and useful property constructed between Dec. 31, 1936 and June 1, 1937.

Working Capital.

In the Commission's report and order, it determined that a fair allowance for working capital was $164,000 in which Appellee concurs (R. 28).

Going Concern Value.

A careful estimate of going concern value was made by Appellee. Witness Seelye testified that this value, based on a consideration of the relevant factors, was not less than $400,000 (R. 796). All the pertinent facts and circumstances in the financial history of the Appellee were considered in arriving at this figure. **The Commission offered no testimony as to going concern value.** In its order of November 30, 1937, the Commission failed to make a separate allowance for going concern value, stating that it had nevertheless considered it in arriving at fair value (R. 24-27). No evidence of such consideration is apparent.

Rate of Return.

The Commission offered no evidence dealing directly with fair rate of return nor did it attempt to contradict Appellee's evidence with respect thereto.

Commission's witness McShea introduced into evidence and testified from exhibits prepared by him relative to (i) bond yields and prices of Pennsylvania electric utilities, (ii) prices and yields of preferred stock of Penn-

sylvania public utilities, (iii) New York money rates from January, 1932 to April, 1937, and (iv) earnings on common stocks according to ratios of earnings to high market prices. (R. 1007, 1008, 1012, 1013). This witness, whose qualifications as an expert in matters of utility finance and financing were challenged by Appellee and were not established by his testimony, stated that he had no information as to what it would cost Appellee to attract capital; that he had no opinion as to what Appellee would have to pay for money under the existing circumstances; and that he had made no study of the trend of the present utility bond market (R. 978-984).

Appellee introduced the testimony of witness Henry D. Boenning, a banker and broker experienced in the underwriting and public sale of utility securities (R. 1042-1068). He testified that he was familiar with the business and affairs of the Appellee, that he had studied its balance sheets and knew its earnings for 1935, 1936 and 1937; that he had made inquiry and investigation of the cost of financing Appellee; that he was ready, willing and able to finance Appellee on the following basis, which was the lowest possible basis on which Appellee could be financed through public participation: $5,500,000 (minimum fair value claimed by Appellee (R. 800)) through the issuance of (1) $3,100,000 of 20 year 5% bonds to net the company $97 on each $100 bond, or a total of $3,007,000; (2) $1,350,000 through the sale of 27,000 shares of $3.50 preferred, par $50, to net the company $1,218,375; (3) 100,000 shares of common stock, par $10, to net the company $1,275,000 (R. 1053). In order to meet its fixed charges and insure the sale of its securities, the company would have to earn at least 7.88% on this minimum fair value, or $432,650 (R. 1051-

1053); $155,000 for bond interest, $94,500 for preferred stock dividends, $178,500 for common stock and $4,650 for amortization of bond discount (R. 1053).

A similar statement on the basis of financing $5,250,000 (Commission's rate base) indicated a minimum rate of return of 7.8%, or $409,300, to meet its fixed charges and insure the sale of its securities (R. 1054). Mr. Boenning cited in support of his testimony public utility bonds and stocks, including those of Pennsylvania companies, which were then selling in the open market on a basis comparable to that outlined by him (R. 1046-1051).

His testimony was corroborated by Appellee's witness, Knutson, utility financial and operating consultant, who, after stating his familiarity with the property and business of the Appellee and its earning statements for 1935, 1936 and 1937, testified that a rate of return of at least 8% was necessary if Appellee was to maintain its high grade of service to the public, preserve its credit and be able to attract capital at a reasonable cost (R. 1071). Both of these witnesses testified that the activities, agencies and attitude of the federal and Pennsylvania governmental administrations had increased the cost of money to public utilities by frightening the investor, and that the rate-making powers conferred upon the Pennsylvania Public Utility Commission by Section 310 of the Public Utility Law and statements attributed to members of the Commission weakened the ability of Pennsylvania utilities to attract capital and raised the cost of the same (R. 1056, 1072-1080).

Operating Expenses.

The **uncontradicted** evidence before the Commission shows that the Appellee incurred rate case expense in

the presentation of evidence before the Commission and in matters growing out of the investigation which the Commission instituted on its own motion, in the amount of $178,374.50 (R. 1037).

No attempt has been made by the Commission, through the introduction of evidence or otherwise, to deny the fact that these expenses have actually been incurred or that they are proper and reasonable and necessarily incident to the investigation instituted by it.

A resolution of Appellee's board of directors adopted on October 28, 1937, increasing the annual salary expense of Appellee in the amount of $20,593.00 was, by stipulation, made a part of the record in the rate proceeding (R. 1035).

The record shows that heretofore the Appellee has derived an annual profit of $15,000 from sales of electric energy to York Railways Company, which will disappear with the abandonment of its railway services. (Appellee Exhibit No. 7, R. 1018).

Continuing Property Records.

E. C. Isele, vice president of the Appellee, testified, that Appellee did not keep continuing property records (R. 1106). He also stated that during the twelve months' period ending December 31, 1937, the company had made 5,671 service connections, and 4,704 service disconnections (R. 1108); that the operating income of Appellee for the calendar year 1935 was $612,602.20 and for the calendar year 1936, $568,711.93 and for the 12 months ending September 30, 1937, $606,921.05 (R. 1106, 1031). These figures are each greatly in excess of the net operating income allowed by the Commission in its order dated November 30, 1937.

QUESTIONS INVOLVED.

(1) Does the order of the Commission ignore the statutory requirements of Section 310 of the Pennsylvania Public Utility Law?

(2) Does Section 310 of the Pennsylvania Public Utility Law contravene the provisions of the Constitution of the United States and the Fourteenth Amendment thereto and the Constitution of the Commonwealth of Pennsylvania?

(3) Does the order of the Commission violate the Provisions of the Constitution of the United States and the Fourteenth Amendment thereto?

OUTLINE OF THE ARGUMENT.

The infirmities of the statute and of the Commission's order made pursuant thereto are briefly stated in the following outline of argument.

I. The order complained of is invalid because the Commission failed to comply with the specific provisions of Section 310 of the Pennsylvania Public Utility Law. The Commission affirmatively states that in making its order of November 30, 1937, it proceeded under subparagraph (a) of Section 310. Subparagraph (b) of Section 310 is specifically and exclusively applicable to cases where the utility corporation does not have continuing property records. The evidence in this case is uncontradicted that the Appellee does not have continuing property records. The evidence is likewise uncontradicted that the allowable return to the Appellee under the specific provisions of subparagraph (b) of Section 310 is far in excess of the return permitted by the Commission's order.

II. Section 310 of the Pennsylvania Public Utility Law violates the provisions of the Fourteenth Amendment to the Federal Constitution and the Constitution of the Commonwealth of Pennsylvania, and is therefore invalid.

A. Subparagraph (a) of Section 310 permits the Commission in its uncontrolled discretion to deprive a utility corporation of the essential requirements of due process of law in two respects:

1. It permits the prescription of temporary rates as low as 5% on depreciated original cost of the physical property—i. e. the cost when first devoted to the public use. It thus permits the exclusion from the temporary rate base so determined of allowances for all indirect costs or "general overheads", working capital and going concern value, as well as the exclusion from consideration of reproduction cost and other essential elements of fair value. It permits the wholly unwarranted practice of depreciating original cost. It permits the imposition of an arbitrary rate of return of 5%, without any consideration of the special circumstances affecting any given utility corporation. Subparagraph (a) permits the Commission to prescribe rates by the use of illegal methods, and to disregard relevant evidence of fair value and fair return and to make findings without regard to the evidence of such fair value or fair return. Thus this subdivision permits the Commission to effect a denial of due process of law in the procedural sense.

2. It permits the Commission to prescribe rates yielding a return as low as 5% on depreciated original cost of the physical property, when first devoted to public use thus allowing the Commission to fix rates which in most, if not all, cases

will be confiscatory. It does not require that rates be sufficient to yield a fair return on the fair value of the utility corporation's property used and useful in the public service. Whether or not the rate to be fixed in a given case will yield a fair return on the fair value of the property, or on the contrary, will be confiscatory, is completely within the purported power of the Commission. Thus it permits the Commission to effect a denial of due process of law in the substantive sense.

The very existence of the power to deprive utilities of their property without due process of law, regardless of its exercise, is invalid. The statute must be judged by what it *permits*, and so judged it constitutes:

1. A delegation of unlawful power, since the legislature itself could not prescribe arbitrary rates based solely on 5% of depreciated original cost of physical property when first devoted to public use, and hence cannot delegate to the Commission a power which it does not possess, and
2. An unlawful delegation of power, since the statute contains no standard or framework to guide and limit the exercise of administrative discretion.

B. Subparagraph (b) of Section 310, which provides for a return measured solely by previous net operating income for a year selected by the Commission, wholly without regard to what constitutes a fair return on the fair value of the utility corporation's property, is equally as invalid as subparagraph (a) and for the same reasons.

C. The alternative bases for the prescription of rates provided for in subparagraph (a) and (b) of Section 310, the application of which is to be determined solely

by the mere accident of bookkeeping methods followed by a particular utility, deny to the utility corporations of the Commonwealth of Pennsylvania the eqqal protection of the laws. There can be no sound distinction based solely upon the keeping of, or the failure to keep, continuing property records which justifies such discrimination.

D. Subparagraphs (a) and (b) of Section 310 are not validated by the so-called "recoupment" provision of subparagraph (e). The Constitution makes no distinction between permanent and temporary confiscation; nor is there any degree of confiscation which is permissible under the Constitution. It is, therefore, impossible to avoid the unconstitutional effect of a confiscatory or otherwise illegal rate by a recoupment provision.

Even if this were theoretically possible, it is not accomplished by subparagraph (e) because the loss caused by confiscatory rates cannot be compensated for merely by fixing rates in the future in excess of legal requirements, since this method does not guarantee any recoupment; the recoupment provision of subparagraph (e) is certain neither as to time nor amount; the recoupment provision of subparagraph (e) does not provide for all of the possible elements of damage resulting from the imposition of confiscatory temporary rates.

III. The order of the Commission violates the Federal Constitution in that it denies to the Appellee the requirements of due process of law and just compensation for the taking of its property.

A. The findings and conclusions of the Commission are not supported by substantial evidence.

B. The rates imposed by the Commission's order are confiscatory in that they do not provide the Appellee with a fair return on the fair value of its property used and useful in the public service.

ARGUMENT.

POINT I.

THE COMMISSION'S ORDER OF NOVEMBER 30, 1937, IS INVALID BECAUSE IT FAILS TO COMPLY WITH THE MANDATORY PROVISIONS OF SECTION 310* OF THE PENNSYLVANIA PUBLIC UTILITY LAW.

The Court below found, and the Commission admits, that in imposing temporary rates upon Appellee, the Commission acted under subparagraph (a) of section 310 of the Pennsylvania Public Utility Law. The Court below likewise found that, *if the Commission had any right to impose temporary rates at all,* it should have proceeded under subparagraph (b) of section 310.

It appears of record by the uncontradicted testimony of E. C. Isele, Vice-President of Appellee in charge of its accounting records (R. 1106), that Appellee does not have continuing property records such as the Commission may require under Section 502* of the Pennsylvania Public Utility Law, or continuing property records of any kind. Such records are, in effect, a perpetual inventory of a utility, stated on the basis of original cost. The method for fixing the rates of a public utility which does not have such continuing property records is prescribed in Section 310 (b), which provides in part:

* Printed in full in Appendix A hereof.

"(b) If any public utility does not have continuing property records, kept in the manner prescribed by the commission, under the provisions of section five hundred two of this act, then the commission, after reasonable notice and hearing, may establish temporary rates which **shall** *be sufficient to provide a return of not less than** an amount equal to the operating income for the year ending December thirty-first, one thousand nine hundred thirty-five, or such other subsequent year as the commission may deem proper, to be determined on the basis of data appearing in the annual report of such public utility to the commission for the year one thousand nine hundred thirty-five, or such other subsequent year as the commission may deem proper, plus or minus such return as the commission may prescribe from time to time upon such net changes of the physical property as are reported to and approved for rate-making purposes by the commission. * * *"

The Commission argues in its brief, in an effort to avoid the finding of the Court below and the plain force of the statute, that subparagraph (b) provides merely an alternative permissive procedure for the prescription of temporary rates. However, it is submitted that this subparagraph is clearly **mandatory** to the extent that it requires the Commission, if it proposes to fix temporary rates for a utility which does not have continuing property records, to establish rates sufficient to provide a return of not less than the operating income of the utility for the year 1935 or any subsequent year.

The only permissive word in the statute is the word "may." But it is clear that this permissive word de-

* Emphasis in quotations throughout, ours, unless otherwise indicated.

notes merely the general permission granted to the Commission to fix or not to fix temporary rates as the Commission may desire. If the Commission makes use of this permissive power it "**shall**" adopt the method, and meet the test, provided in the appropriate subparagraph of Section 310.

Each subparagraph thereof provides that the Commission "**may**" fix rates. Thus subparagraph (a) provides that the Commission "may" fix temporary rates which "**shall**" be sufficient to provide a return of "not less than" 5% of depreciated original cost of the physical property when first devoted to public use of the utility. Subparagraph (c) provides that the Commission "may" prescribe temporary rates at intervals in the manner provided in subparagraphs (a) or (b). Subparagraph (d) provides that the Commission "may" prescribe trial rates which "**will produce**" a fair return on fair value. Subparagraph (b) provides, that where a utility does not have continuing property records, the Commission "may" establish temporary rates which shall be computed upon the basis therein provided. Manifestly the word "may" is used in the same sense in each subparagraph and refers only to the general discretion granted to the Commission to fix or not to fix temporary or trial rates. In each subparagraph the method by which such rates shall be fixed is mandatory.

The authority to prescribe temporary rates under subparagraph (b) is *permissive,* but if the utility does not have continuing property records, it is *mandatory* that the temporary rates so prescribed "**shall** be sufficient to provide a return of not less than" the operating income of the utility for the year 1935 or for any subsequent year.

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The mandatory words "shall" and "not less than" would be meaningless if the generally permissive word "may" were held to control them. Such a construction would be a clear violation of express language.

Moreover, such a construction would be a clear violation of the intent and purpose of Section 310. It was presumably designed to provide a reasonably simple and expeditious method of effecting a reduction in rates pending the determination of proceedings to fix permanent rates. This purpose can be accomplished by the use of original cost as a rate base only where the records of the utility furnish a quick and certain guide to that cost. Where they do not, it is obvious that a determination of original cost must be either a mere guess or the result of a lengthy and involved investigation and determination of fair value. It is for this reason that the Legislature of Pennsylvania, instead of merely empowering the Commission to prescribe temporary rates, attempted to fix two separate and distinct methods to be used by the Commission, as a part of a long range program designed to facilitate the speedy prescription of temporary rates. Where the utility has continuing property records in the form prescribed by the Commission, subparagraph (a) may be utilized, for such records supply original cost data in the Commission's prescribed form, and rates based on or tested by original cost, as they are under subparagraph (a), may readily be determined. But where such records are not available a different method must be employed. This method is set forth in detail in subparagraph (b), and supplies a short-cut control of rates where there are no original cost records in the Commission's prescribed form. The two methods together provide a comprehensive scheme of regulation.

The Commission's failure to act under subparagraph (b) of Section 310 as the statute required it, has resulted in the imposition of temporary rates on Appellee, calculated to yield a net return of $384,000. It is unquestioned on the record that its net operating income for 1935 or any subsequent year, the measure of rates under subparagraph (b), was never less than $568,000. **Thus the Commission has ordered a reduction in gross operating revenues which, according to the Commission's own figures, will result in a net operating income of far less than that of any of the three years which the Commission is authorized by Section 310 (b) to use in imposing its temporary order.**

This illustrates conclusively the degree to which the finding of the Commission as to the allowable net income fails to conform with the mandatory provisions of the statute under which the Commission acted in fixing temporary rates. The Commission has made no attempt to comply with the law under which it derives its authority.

It is submitted that for this reason alone the action of the Commission and the imposition of temporary rates prescribed in its order of November 30, 1937, are invalid and without statutory authority, that the statutory Court's finding in this regard is correct, and that the permanent injunction against the enforcement of those rates was properly issued.

POINT II.

SECTION 310 OF THE PENNSYLVANIA PUBLIC UTILITY LAW VIOLATES BOTH THE FEDERAL CONSTITUTION AND THE CONSTITUTION OF THE COMMONWEALTH OF PENNSYLVANIA,* AND THE ORDER OF THE COMMISSION, IMPOSED UNDER THAT SECTION, IS INVALID.

Section 310 permits the Commission in any proceeding involving rates brought either on its own motion or on complaint, if it be of the opinion that the public interest so requires, immediately to fix and prescribe temporary rates.

As shown in Point I, two bases or measures are provided for the prescription of such temporary rates, the application of which is dependent upon the existence or non-existence of continuing property records of the particular utility involved. If the utility has such records, and the Commission elects to impose temporary rates, the rate may be as low as 5% of the original cost less accrued depreciation of the physical property of the utility when first devoted to public use (Subparagraph (a)). If it has no such records, and the Commission elects to impose temporary rates, the rate may be as low as the operating income of the utility for the year 1935 or any subsequent year selected by the Commission, based upon annual report data plus or minus net changes in the physical property of the utility adjusted by the Commis-

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* Each of the subparagraphs of Section 310 is demonstrably unconstitutional. However, inasmuch as the present order of the Commission requires consideration only of subparagraphs (a), (b) and (e), the Appellee will confine its discussion and analysis to these specific subparagraphs.

sion as it deems fit (Subparagraph (b)). *Both bases ignore consideration of the present fair value of the utility's used and useful property.*

A.

Subparagraph (a) of Section 310 Is Unconstitutional Because It Permits the Commission In Its Uncontrolled Discretion to Deprive a Utility Company of the Essential Requirements of Procedural and Substantive Due Process of Law, and Thus Constitutes a Delegation of Unlawful Power and An Unlawful Delegation of Legislative Power.

Subparagraph (a) permits the Commission to prescribe a temporary rate which yields a return of only 5% on the original cost, less accrued depreciation, of the *physical* property of the utility when first devoted to the public use. Obviously such a rate can not provide that fair return upon the fair value of *all* of the utility's property used and useful in the public service, to which every public utility is constitutionally entitled. Likewise, this permitted minimum measure of return completely fails to take into consideration all but one, and only a part of that one, of the elements of fair value and fair return prescribed by the decisions of this Court. Section 310 (a) also permits the Commission to apply to this unconstitutional rate base a wholly arbitrary rate of return which fails to take into consideration any circumstances relating to the particular utility under consideration. The fact that the rates thus prescribed are temporary is without significance, since the requirements of procedural due process have been violated by the bases and methods used in fixing the rates.

We submit that the very existence of such a power directly violates the Constitutions of the United States and of the Commonwealth of Pennsylvania. *This contention requires a discussion first, of the nature and practical effect of this power, and second, of the legal effect of its existence.*

With respect to the first question, the essential requirements of due process of law demand that in prescribing rates the Commission must afford adequate notice and opportunity to be heard which includes the admission of all relevant evidence which may be offered, the opportunity to examine opposing testimony and a determination based on an adequate consideration of the entire record. This means that the Commission *must* consider and base its determination on:

(1) relevant evidence of present cost of construction, including indirect costs, working capital, going concern value, and all other evidence of "fair value"; and

(2) relevant evidence of what constitutes a fair return.

We submit that subparagraph (a) delegates to the Commission's uncontrolled discretion the power to ignore all such evidence, except that relating to depreciated original cost of physical property when first devoted to public use, to disregard all lawful methods of arriving at fair value and fair return, and, finally, to enter an order wholly unsupported by substantial relevant evidence. The purported authority to deny procedural due process carries with it impliedly a like authority to deny substantive due process, for in the exercise of that authority confiscatory rates may be imposed.

With respect to the second question, we submit that the legal effect of such purported power to deny due process, is a delegation of unlawful powers, and an unlawful delegation of powers—equally invalid.

1. Subparagraph (a) of Section 310 Permits the Commission to Deprive a Utility of the Essential Requirements of Due Process of Law.

(a) *Procedural Due Process of Law.*

The precedural requirements of due process of law have been firmly embedded in constitutional doctrine for many years. As applied to administrative tribunals, they were originally confined to the elemental concepts of adequate notice and hearing. However, with the tremendous growth of administrative law, and the consequent expansion both in numbers and in power of state and federal administrative bodies, this Court has gradually enlarged these requirements to cover first, admission and adequate consideration of all relevant evidence which may be offered; second, action which can be supported by substantial evidence and which, in the light of all of the evidence, is not arbitrary; and third, the utilization of reasonable and proper methods in arriving at an ultimate conclusion. It becomes important then, in the instant case, to determine whether or not the statute meets the constitutional tests imposed by this Court.

As a point of departure, it may be stated categorically that judicial review of the acts of administrative tribunals extends to their *procedure* in making orders.

Interstate Commerce Commission v. Ill. Cent. R. R., 215 U. S. 452 (1910).
Interstate Commerce Commission v. Union Pac. Ry., 222 U. S. 541 (1912).

Interstate Commerce Commission v. Northern Pac. Ry., 216 U. S. 538 (1910).
Railroad Commission v. Cumberland Tel. & Tel. Co., 212 U. S. 414 (1909).
Cedar Rapids Gas Light Co. v. Cedar Rapids, 223 U. S. 655 (1912).
Kansas City So. Ry. v. U. S., 231 U. S. 423 (1913).

Thus, orders of regulatory agencies have been invalidated because no adequate or fair hearing was allowed;

Interstate Commerce Commission v. Louisville and Nashville Ry., 227 U. S. 88 (1913).
Atchison, Topeka & S. F. Ry. v. U. S., 284 U. S. 248 (1932).

or because there was no substantial evidence to support them or because the Commission considered matters which were not in the record or which, even though in the record, could not legally influence its judgment;

Minnesota Rate Cases, 230 U. S. 352 (1913).
United States v. Abilene & So. Ry., 265 U. S. 274 (1924).
Southern Pac. Ry. v. I. C. C., 219 U. S. 433 (1911).
Ann Arbor R. Co. v. U. S., 281 U. S. 658 (1930).
Ohio Utilities Co. v. Ohio Public Utilities Commission, 267 U. S. 359 (1925).
West Ohio Gas Co. v. Ohio Public Utilities Commission, 294 U. S. 63 (1935).

or because the Commission refused to consider evidence which was introduced or which, as a matter of law, the Commission should have considered.

So. Pac. Ry. v. I. C. C., 219 U. S. 433 (1911).
B. & O. R. R. v. U. S., 264 U. S. 258 (1924).

St. Louis & O'Fallon R. v. U. S., 279 U. S. 461 (1929).

Missouri ex. rel. Bell Tel. Co. v. Public Serv. Comm., 262 U. S. 276 (1923).

Thus, it appears that the essential requirements of due process of law **compel adequate notice and opportunity to introduce all relevant evidence, and to examine opposing evidence, and a judgment based upon the entire record.** These are the standards of due process of law which the foregoing cases have uniformly applied to the methods and procedure of administrative and regulatory agencies. We submit that provisions of Section 310(a) do not meet these constitutional standards.

As heretofore pointed out, this section permits the Commission to prescribe rates based solely upon original cost, to consider only the original cost of the physical property of the utility when first devoted to public use, and further to depreciate that cost. It is clear that the statute requires consideration of only one part of one of the elements of fair value, and permits the Commission to disregard the many other well established elements which are relevant to, and must be considered in the fixing of rates.

In the leading case of *Smyth v. Ames*, 169 U. S. 466, 546-547, (1898), this Court laid down the essential basis for the prescription of rates as a fair return on the fair value of the property devoted to the public use. And in the same case the Court prescribed the factors which must be considered, as follows:

"And in order to ascertain that value, **the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the**

> **original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses,** are all matters for consideration, and are to be given such weight as may be just and right in each case."

These principles have been reiterated and elaborated by this Court in numerous cases since the rule was first announced.

It has been firmly established that reproduction cost or present cost is an essential element of the rate base and must be given due consideration in fixing fair value. In *Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission of Missouri, et al.*, 262 U. S. 276 (1923), the Court said, at pages 288-9:

> "It is impossible to ascertain what will amount to a fair return upon properties devoted to public service *without giving consideration to the cost of labor, supplies, etc., at the time the investigation is made.* An honest and intelligent forecast of probable future values, made upon a view of all the relevant circumstances, is essential. If the highly important element of present costs is wholly disregarded, such a forecast becomes impossible. *Estimates for tomorrow cannot ignore prices of today.*"

See also:

St. Louis & O'Fallon Railway Co., et al. v. United States, et al., 279 U. S. 461 (1929);
Los Angeles Gas & Electric Corp. v. Railroad Commission, 289 U. S. 287 (1933);
West v. Chesapeake & Potomac Tel. Co., 295 U. S. 662 (1935);
Bangor Water Co. v. Public Service Commission, 82 Pa. Superior Ct., 48 (1923);
Erie City, et al., Appellants v. Public Service Commission, 278 Pa. 512 (1924).

Innumerable other decisions of this Court from 1898 to the present day lay down the hard and fast rule that original cost is *not* the sole measure of fair value, and that reproduction cost and all other elements affecting value must be given consideration in the fixing of rates.* In *West v. Chesapeake & Potomac Telephone Company, supra,* the Court stated, at page 672:

> "We have therefore held that where the present value of property devoted to the public service is in excess of original cost, the utility company is not limited to a return on cost. Conversely, if the plant has depreciated in value, the public should not be bound to allow a return measured by investment. *Of course the amount of that investment is to be considered along with appraisal of the property as presently existing, in order to arrive at a fair conclusion as to present value, for actual cost, reproduction cost and all other elements affecting value are to be given their proper weight in the final Conclusion.*"

This rule, we submit, was in no wise altered by the decision of this Court in *Railroad Comm. of California v. Pacific Gas & Electric Co.,* 302 U. S. 388 (1938), where the Court held merely that the Commission was justified in ignoring evidence of reproduction cost which was so con-

* The Commission devotes a large part of its brief to the proposition that reproduction, or present, cost should not be used as any index of value at all, and that no rate which allows a fair return on so-called "original cost prudently made" can be invalid or unconstitutional. The Appellee will not comment upon this argument in this part of its brief, since it is dealing here with the law as it has been announced by this Court and *now exists*, rather than with a request to this Court to *change the existing law*. A discussion of this point of the Commission's argument, however, will be found in Appendix B to this brief. In any event, even if the Commission's theory were adopted, the instant statute would nevertheless be invalid, since it prescribes the standard not of original cost or prudent investment, but a depreciated original cost of the physical property when first devoted to public use ignoring all indirect costs, working capital, and going concern value, and permits the use of an arbitrary rate of return, all of which are hereinafter thoroughly discussed.

jectural as to be of no probative value whatever. This was in no sense a holding that the Commission could legally ignore substantial evidence of present cost or value.

Moreover, the depreciation of the original cost of any kind of property, permitted by subparagraph (a), produces an utterly meaningless figure and one which certainly is not, and never has been, recognized as having any connection whatever with a rate base. Original cost is the expression of the dollars invested in the property; the cost is not a variable figure. Because the cost is immutable, it does not depreciate and cannot be depreciated. Even those who advocate the adoption of the so-called prudent investment theory (see concurring opinion of Brandeis, J. in the *Southwestern Bell Telephone Company Case, supra*), do not argue that when such original or historical cost prudently made is ascertained, the same should be depreciated in determining the rate base.

Such a monstrosity as "depreciated original cost" is meaningless as an index of value. It does not represent present cost. It does not represent historical cost. It does not represent present value. It does not represent anything. The Commission itself has on numerous recent occasions realized this and expressed itself against the concept of depreciated original cost. In its order nisi in the case of *Pennsylvania Public Utility Commission et al. v. Solar Electric Company*, 24 P. U. R. (N. S.) 337 (1938), (subsequent to its opinion in the case at bar) the Commission stated:

> "It is the opinion of the Commission that the original cost of existing property, prudently invested, used and useful in utility enterprise, without any deduction for accrued depreciation represents the money which has been invested and should, therefore, constitute a proper rate base. The purpose of adopt-

ing original cost is to create a non-fluctuating rate base which will insure the investor a definite return, and at the same time, eliminate the premium which has been placed upon the ability of the utility to create imaginative values. In the instant case before the Commission the original cost rate base actually represents an amount of dollars prudently invested and it must therefore, follow that such amount *is not susceptible of deductions for depreciation* accrued on property itself. By this we mean that depreciation which may be accrued on such property as buildings, or the poles and wires of a distribution system, cannot be said to lessen the dollars of investment in that property."

The same language was used by the Commission in its order nisi in the case of *Pennsylvania Public Utility Commission v. Yardley Water & Power Co.*, [unreported] C. D. No. 11545 Pa. P. U. C., dated September 27, 1938, (likewise subsequent to its opinion in the case at bar) wherein the Commission adopted undepreciated original cost of used and useful property as a rate base and held that original cost could not be depreciated.

Another factor which this Court has required commissions to take into consideration is the necessary and experienced indirect costs which contribute to the value of a utility property as a whole. These costs were specifically recognized by the Court in *Des Moines Gas Company v. City of Des Moines*, 238 U. S. 153 (1915), wherein the Court confirmed the report of a special master which stated, at pages 166-7:

"'In reaching the physical value of the plant in question by the process of reproduction, it is necessary to bear in mind that the present value thereof represents much more than the machinery therein, the labor of installing and constructing them, and putting them in place to perform their various functions, ready for the manufacture and distribution of

> gas to its customers. Were the City of Des Moines without such a plant, and such a one as the complainant now owns was proposed, it would be found that much more than the mere cost of labor and material would be expended. Such expenditures are termed overhead charges * * *."

To the same effect is the statement in *Brooklyn Borough Gas Company v. Prendergast, et al.*, 16 F. (2d) 615 (D.C. E.D. N.Y., 1926), at page 629:

> "It is elemental industrial economics that the cost of land, material and labor does not represent the full amount that it is necessary to use in production or construction. That overheads are necessary, unavoidable, and must be allowed in this type of cases is recognized."

The uniform system of accounts relating to electric corporations, as prescribed by the Commission and now in force, recognizes the necessity of an allowance for general overheads in the capital accounts of such companies. It was so admitted by the sitting commissioner in this case (R. 560).

It is universally recognized that a reasonable allowance for working capital must be made in determining the fair value of property for rate making purposes. Yet this statute permits the complete exclusion of this essential element. As was stated in *Brooklyn Borough Gas Co. v. Prendergast, et al. (supra)* at page 631:

> "Of the necessity of adequate working capital in the management of any enterprise there can be no argument. It is the daily lifeblood stream of the business; it keeps the pay of those laboring for the company and the bills of his creditors in supply houses paid promptly."

Although Appellee concedes that going-concern value is not "something to be read into every balance sheet"

(*Dayton Power & Light Co. v. Ohio P. U. C.*, 292 U. S. 290 (1934)) it is submitted that the necessity of *considering* going concern value as an element of fair value for rate purposes has been clearly and definitely established by the decisions of this Court. In *Des Moines Gas Company v. City of Des Moines* (*supra*), the Court stated, at page 165:

> "That there is an element of value in an assembled and established plant, doing business and earning money, over one not thus advanced, is self-evident. This element of value is a property right, and should be considered in determining the value of the property, upon which the owner has a right to make a fair return when the same is privately owned, although dedicated to public use."

The necessity and propriety of such an allowance, where there is substantial evidence of its existence, arises from the fact that a plant in operation with customers attached has a value over and above the cost of the mere physical property, and this should be included in the rate base in order to arrive at "fair value."

See:

Galveston Electric Co. v. City of Galveston, et al., 258 U. S. 388 (1922);
Los Angeles Gas & Electric Corp. v. Railroad Commission, supra;
Dayton Power and Light Co. v. Public Utilities Commission of Ohio, supra;
Columbus Gas & Fuel Co. v. Public Utilities Commission of Ohio, 292 U. S. 398 (1934);
International Ry. Co. v. Prendergast, et al., 1 Fed. Supp. 623, (D. C. W. D. N. Y., 1932);
Brooklyn Borough Gas Company v. Prendergast, supra.

In addition to the defects of Section 310 (a), pointed out above, the statute is further defective in its approval of a wholly arbitrary rate of return of 5%. The use of any fixed rate of return has many times been proscribed by this Court.

In *United Railways v. West*, 280 U. S. 234 (1930), this Court recognized the fluctuating nature of a fair rate of return, stating, at page 249:

> "What is a fair return within this principle cannot be settled by invoking decisions of this court made years ago based upon conditions radically different from those which prevail today. The problem is one to be tested primarily by present-day conditions. * * * *Nor can a rule be laid down which will apply uniformly to all sorts of utilities. What may be a fair return for one may be inadequate for another, depending upon circumstances, locality and risk. Willcox v. Consolidated Gas Co.*, 212 U. S. 19, 48-50."

Likewise, in *Bluefield Water Works & Improvement Company v. Public Service Commission of the State of West Virginia*, 262 U. S. 679 (1923), the Court stated, at page 692:

> "What annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts."

See also: *Willcox v. Consolidated Gas Co.*, 212 U. S. 19 (1909); *Pennsylvania Power and Light Co., Appellant v. Public Service Commission*, 128 Pa. Superior Ct. 195 (1937); *Chambersburg Gas Company, et al., v. Publice Service Commission*, 116 Pa. Superior Ct. 196 (1935).

The foregoing review of the more important decisions of this and other courts demonstrates that a rate is constitutional only if it provides a fair return upon the fair value of the utility's property used and useful in the public service. It is also clear that in determining such a constitutional rate certain factors must be considered if there is any substantial evidence to support them. These factors include original and present cost, each including indirect as well as direct costs, working capital and going concern value. Lawful rate making requires a consideration of not one, or a part of one of these factors, but all of them, as the judgment must be reasonable and based on a consideration of all of the relevant facts. As was stated by Chief Justice Hughes in the *Minnesota Rate Cases*, 230 U. S. 352, 434 (1913),

> "The ascertainment of that value is not controlled by artificial rules. It is not a matter of formulas, but there must be a reasonable judgment having its basis in a *proper consideration of all relevant facts.*"

The standard so enunciated has been consistently followed by this Court. *Northern Pac. Ry. v. Dept. of Public Works of Washington*, 268 U. S. 39 (1925). Its latest expression may be found in the recent opinion of this Court in *West, et al., v. Chesapeake and Potomac Tel. Co.*, 295 U. S. 662 (1935), wherein this Court, without a finding of confiscation, condemned a rate because the method used by the Commission, namely, the application of a conglomerate mixture of price indices, did not conform to the constitutional standards of administrative procedure. The method of rate making permitted by Subparagraph (a) completely disregards not only the general concept of fair return upon fair value of property, but also the specific factors which this Court

has held must be given due consideration in the determination of such fair return upon fair value, in that:

(1) Present cost or value is completely disregarded, despite the fact that it has always been deemed a necessary element of the rate base.

Missouri ex rel. Bell Tel. Co. v. Public Service Commission, 262 U. S. 276 (1923)
California Water & Tel. Co. v. Railroad Commission of California, et al., 19 Fed. Supp. 11 (D. C. N. D. Cal. 1937).

(2) Original cost is made subject to depreciation, although it is obvious that such cost is constant.

(3) It permits the Commission to confine its consideration of this depreciated original cost to the **physical** property of the utility, disregarding all indirect costs and overheads contrary to established law.

Des Moines Gas Company v. City of Des Moines 238 U. S. 153 (1915)
Brooklyn Borough Gas Co. v. Prendergast, et al., 16 F. (2d) 615 (D. C. E. D. N. Y. 1926).

(4) This original cost when first devoted to public use is not even the investment of the present owner, but that of the first owner.

(5) Section 310 (a) permits the entire exclusion of the necessary allowance for working capital.

Brooklyn Borough Gas Co. v. Prendergast, et al., supra.

(6) No consideration need be given for going concern value despite the fact that this is a necessary element to be considered in any valid rate base.

Des Moines Gas Company v. City of Des Moines, supra.

The foregoing discussion establishes conclusively that Section 310 (a) permits the Commission to exclude or disregard evidence of almost all of the factors relevant to a determination of fair value, as well as evidence relating to a fair rate of return.

(7) An arbitrary rate of return may be imposed.

United Railways v. West, 280 U. S. 234 (1930).

Thus, it permits the Commission to conduct a manifestly unfair hearing; to enter an order without proper evidence of fair value and fair return, and to refuse to consider relevant evidence and evidence which, as a matter of constitutional law, must be considered in prescribing rates. **Clearly this is a violation of the constitutional standards of due process of law.**

(b) *Substantive Due Process Of Law.*

Section 310 (a) also violates the requirements of due process of law in the substantive sense. As heretofore pointed out, by permitting the Commission to prescribe rates as low as 5 per cent on depreciated original cost of the physical property of the utility when first devoted to public use, the statute allows the Commission to fix confiscatory rates. There is nothing which compels the Commission to consider factors of value which must enter into a proper determination of fair value. Surely it cannot be said that original cost is synonymous with fair value. Moreover, additional elements of property such as overheads, working capital, and going concern value may be disregarded.

This Court has never approved an arbitrary rate of return such as the 5 per cent permitted by Section 310(a). It is inconceivable that in any instance the rate of return based as it is on the depreciated original cost of the util-

ity's property when first devoted to public use could result in a non-confiscatory return. In most if not all instances it is evident that the Commission is given the power to fix a confiscatory rate.

Thus, in these various ways Section 310(a) gives the Commission the power to deprive a utility of its property without just compensation and without due process of law.

2. The Attempt to Clothe the Commission with Unlimited Power to Disregard Constitutional Rights Is in Itself Unconstitutional.

The foregoing discussion under subsection 1 of this point demonstrates that Section 310(a) purports to empower the Commission in its uncontrolled discretion to deprive a utility company of the essential requirements of due process of law in the procedural sense, and to fix and prescribe confiscatory rates which deprive the utility of due process of law in the substantive sense. As a consequence, the statute is invalid and a violation of the Constitution of the United States, and also of the Constitution of the Commonwealth of Pennsylvania.

(a) *Delegation of Unlawful Power.*

Section 310(a) contains only one standard of administrative action—5% of depreciated original cost of physical property when first devoted to public use. We submit that the foregoing discussion has demonstrated that it is an unconstitutional standard—that not only confiscation of the property of a utility, but also a denial of the essential requirements of procedural due process of law, is committed to the sole and uncontrolled discretion of the Commission.

Moreover, the Commission itself concedes that the measure of return permitted by the statute may be confiscatory. This power—to deprive a utility of its constitutional rights—is a power which the legislature itself does not possess. Clearly, the legislature could not pass a law definitely prescribing rates for all utilities in Pennsylvania sufficient to yield a return of 5% of depreciated original cost of physical property when first devoted to public use of the utilities. Such a statute would be obviously unconstitutional. Therefore, although it is not disputed that the power to fix rates is a legislative function which may properly be delegated to a commission, there can be no delegation of a power to fix confiscatory rates—a power which does not exist anywhere, even in the legislature itself. This limitation upon the delegation of power is implicit in the words of Chief Justice Marshall in the case of *Wayman v. Southard, et al*, 10 Wheaton 1, 43 (1825), wherein he stated:

> "• • • but Congress may certainly delegate to others, powers *which the legislature may* **rightfully** *exercise itself.*"

It is no answer to say that the statute is permissive and that it must be presumed that the Commission will not act in an arbitrary manner. It is too clear for argument that a statute must be judged by what it permits, regardless of what may be done in specific instances.

In other words, the statute must prescribe a constitutional standard, a legal and valid frame-work within which the discretion of the administrative body must be exercised. If the statute does not set constitutional limits for this frame-work, it is invalid.

Thus, in *People v. Klinck Packing Company*, 214 N. Y. 121 (1915), the Court of Appeals of New York stated, at page 138:

> "The question whether the statute shall take effect in any, all or no cases, is left wholly to his (Commissioner's) volition. Under its terms he has the power without check or guidance, so far as we can perceive, to veto the entire clause and decide that its benefits shall never be extended to any case, although it comes within the precise terms of the statute, or to permit the exemption in one case and deny it in another precisely similar one. *Of course, it is not to be assumed that the Commissioner of Labor would intentionally be arbitrary and unreasonable in the exercise of this power, but nevertheless, the legislature has attempted to confer upon him the opportunity which would permit of these shortcomings*, **and we are to judge of a statute by what is possible under it.**"

Likewise, the Supreme Court of the United States stated in *Panama Refining Company v. Ryan*, 293 U. S. 388 (1935), at page 420:

> "The question whether such a delegation of legislative power is permitted by the Constitution is not answered by the argument that it should be assumed that the President has acted and will act for what he believes to be the public good. *The point is not one of motives but of constitutional authority for which the best of motives is not a substitute.*"

See also:

Security Trust & Safety Vault Co. v. Lexington, 203 U. S. 324, 333, (1906).

The Montana Co. v. The St. Louis Mining & Milling Co., 152 U. S. 162, 170 (1894).

In Re Christensen, 43 Fed. 243, 247, (C. C. N. D. Cal. 1890).

Grainger v. Douglas Park Jockey Club, 148 Fed. 513, 520 (C. C. S. D. N. Y. 1903).

In the instant case the legislature of Pennsylvania has, by Section 310, attempted to clothe the Commission with the power to prescribe arbitrary, confiscatory and unconstitutional temporary rates,—a power which the legislature itself does not and never can have and which, therefore, it cannot delegate to the Commission. A statute which places the right to exercise such power in the hands of an administrative body is, therefore, doubly invalid.

This rule finds a striking analogy in cases dealing with the constitutional requirement of reasonable notice and an opportunity to be heard in any judicial proceeding. Recently this Court has held that a necessary element of state statutes authorizing proceedings against non-residents is a *requirement*, not merely a permission, that reasonable notice be given to the prospective defendant.

In *Wuchter v. Pizzutti*, 276 U. S. 13 (1928), the Court considered the validity, under the Fourteenth Amendment, of a New Jersey statute which provided for service of process on non-residents of a state in suits for injury due to the negligent operation of automobiles on the State's highways. In the particular case involved, Wuchter, a resident of Pennsylvania, was involved in an accident while driving upon the highways of New Jersey. An action was instituted against him by Pizzutti, and he was served with process by leaving the process with the Secretary of State. No defense was interposed and an interlocutory judgment was taken against him. It appeared of record that after the interlocutory judgment was taken, notice of its proposed execution was actually and personally served on Wuchter in Pennsylvania despite the absence of such a requirement in the statute. Wuchter did not appear and a final judgment was entered. He then appealed to the Supreme Court, contending

that the New Jersey statute under which process was served upon him was unconstitutional as a denial of due process of law.

On these facts, a majority of this Court reversed the judgment on the grounds (page 25):

> "* * * that the statute of New Jersey under consideration *does not make provision for* communication to the proposed defendant such as to create reasonable probability that he would be made aware of the bringing of the suit * * *";

After holding that the statute under consideration did not meet the minimum requirements of due process of law, the Court commented upon the fact that these requirements had actually been met in the case before it by the personal service of notice. In this connection the Court stated (page 24):

> "But it is said that the defendant here had actual notice by service out of New Jersey in Pennsylvania. He did not, however, appear in the cause and such notice was not required by the statute. *Not having been directed by the statute, it can not, therefore, supply constitutional validity to the statute or to service under it.* Coe v. Armour Fertilizer Works, 237 U. S. 413, 424, 425; Louisville & N. R. Co. v. Central Stock Yards Co., 212 U. S. 132, 144; Central of Georgia R. Co. v. Wright, 207 U. S. 127, 138; Security Trust & S. V. Co. v. Lexington, 203 U. S. 323, 333; Roller v. Holly, 176 U. S. 398, 409; Stuart v. Palmer, [25] 74 N. Y. 183, 188; Berryhill v. Sepp, 106 Minn. 458."

Here we have a clear holding that a statute which does not require compliance with constitutional standards is invalid, and any action taken pursuant to such a statute is utterly void, regardless of the fact that in any particular case constitutional standards have been complied with.

In the instant case, as we have seen, Section 310 (a) purports to delegate to the Commission a power which the legislature itself may not rightfully exercise, a power which under our Constitution does not and cannot exist. Such a purported delegation is a complete nullity, and it requires no citation of authority to demonstrate that one cannot give to another what one does not possess.

(b) *Unlawful Delegation of Power.*

Article II, Section 1, of the Constitution of the Commonwealth of Pennsylvania provides:

> "The legislative power of this commonwealth shall be vested in a General Assembly which shall consist of a Senate and a House of Representatives."

The legislative power so conferred may not constitutionally be delegated, except within a framework, prescribed by the legislature, which establishes the standards for administrative action. This is a doctrine not only well established by the decisions of this Court,* but is also firmly embedded in the law of the Commonwealth of Pennsylvania.

In *Holgate Bros Co. v. Bashore*, 331 Pa. 255 (1938) the Pennsylvania Supreme Court stated:

> "Legislative power in Pennsylvania is vested solely in the General Assembly * * * the powers and duties imposed by the Constitution upon the legislative branch of our government remain steadfast and neither the urgency of the necessity at hand nor the gravity of the situation allow the legislature to abdicate, transfer or delegate its authority or duty to another branch of the government. * * *

* See Panama Refining Company v. Ryan, supra; Shechter v. U. S., 295 U. S. 495 (1935); J. W. Hampton, Jr. & Company v. U. S., 276 U. S. 394 (1927).

"The legislature may, however, leave, to administrative officers, boards and commissions, the duty to determine whether the facts exist to which the law is itself restricted. In all such occasions, nevertheless, the legislative body must surround such authority with definite standards, policies and limitations to which such administrative officers * * * must strictly adhere and by which they are strictly governed.

"It is absolutely essential that limits be set on the power conferred on such tribunals and that the scope of their authorized action clearly appear * * * If the legislature fails to prescribe with reasonable clarity the limits of the power delegated or if those limits are too broad its attempt to delegate is a nullity * * *."

In *York Railways Company v. Driscoll*, 331 Pa. 192 (1938), decided the same day as the *Holgate* case, *supra*, the Pennsylvania Supreme Court declared unconstitutional Section 601(a) of the Public Utility Law, relating to the issuance of securities certificates by the Commission, and declared that the provisions of that law, authorizing the Commission to exempt utilities from its requirements as to any class of securities, made the entire provision in question invalid, as an unlawful delegation of legislative power.

See also:

O'Neill v. Insurance Co., 166 Pa. 72 (1895).

Sub-paragraph (a) of Section 310 is a delegation of the legislative power to prescribe temporary rates. There is but one standard stated by the legislature as the sole guide for administrative action by the Commission. This standard—5% of the depreciated original cost of the physical property when first devoted to the public use—is no standard at all; for as we have already shown in the dis-

cussion immediately preceding, it is an unconstitutional standard which the legislature was, therefore, without authority to enact. Stripped of that invalid standard subparagraph (a) is a naked, unrestricted delegation of the legislative power to fix temporary rates—without regard to method, without regard to anything. As such it is a clear violation of the Pennsylvania Constitution.

The test of a state statute by the state constitution is a local matter, normally to be decided by the State courts. In this case, however, while we have no doubt that the Pennsylvania Supreme Court would follow its firmly established and recently reiterated doctrine of unlawful delegation of legislative powers, the Appellee was foreclosed from presenting the question in the State courts, because the terms of the public utility law deny any effective right of appeal from a temporary rate.* However, this Court has ample authority to declare in this case that sub-par graph (a) contravenes the constitution of the Commonwealth.

Sterling v. Constantine, 287 U. S. 378, 393 (1932).
Louisville & N. R. Co. v. Garrett, 231 U. S. 298 (1913).
Railroad Commission v. Pacific G. & E. Co., 302 U. S. 388 (1938).
California Water Service Co. v. City of Redding, 304 U. S. 252 (1938).

It may be argued that if the unconstitutional standard of 5% return on depreciated original cost of physical property when first devoted to public use is deleted,

* Section 1103 of the Pennsylvania Public Utility Law prevents the granting of a supersedeas in cases of appeal from the imposition of temporary rates. Said section is printed in full in Appendix A hereof.

sub-paragraph (a) may be valid because of an implied standard. This contention would rest on the claim that the paragraph, with such deletion, would simply authorize the prescription of temporary rates, and that implicit in such authority would be a standard that such rates be constitutional; or, otherwise stated, that they yield a fair return on the fair value of the utility's property. However, to suppose any such unexpressed intent on the part of the legislature contradicts the intent very clearly expressed and disclosed by the statute itself.

The fact that the legislature prescribed an unconstitutional standard establishes very plainly that it did not intend another and far different standard which happens to be constitutional. Plainly the statute was enacted to provide a *shortcut* method of fixing temporary rates which might be based on the consideration of only a part of one element of fair value. Surely the legislature could not have intended at one and the same time to prescribe a standard for the determination of temporary rates which must include all elements. If we consider subparagraph (b) of Section 310, to which this entire argument is equally applicable, we find the same contradiction. Can it be reasonable to suppose that the same legislature which prescribed annual operating income as the sole standard of rates prescribed under subparagraph (b), where the utility has no continuing property records, intended that the rates be determined on a consideration of all elements of fair value and fair return? Its mere statement shows that such a supposition is preposterous.

As is common in all cases where a statute is attacked as an unlawful delegation of legislative power, a justification is attempted by urging that there is a presumption

that the commission will act properly and by attempting to point out that the statute is permissive and not mandatory in its prescribed standard. Such attempted rebuttal has uniformly been rejected. See *Panama Refining Company v. Ryan, supra; People v. Klinck Packing Company, supra.* The courts of the commonwealth also test the validity of a statute by what it permits. In *Commonwealth ex rel Margiotti v. Sutton, et al.*, 327 Pa. 337 (1938) the court stated at page 345:

> "Another answer made on behalf of the respondents is that 'this clause may never actually be used'; but we must deal with the authority conferred, not with the possibility that the family judges may not exercise it."

It must inevitably be concluded, therefore, that subparagraph (a) of Section 310, for its failure to provide any constitutional standard or framework of administrative action by the Commission in prescribing temporary rates, violates the Constitution of the Commonwealth of Pennsylvania, and is, therefore, a nullity.

B.

Subparagraph (b) of Section 310 Is likewise Unconstitutional.

While the Commission asserts that it proceeded, in making the order complained of, under subparagraph (a) of Section 310, it has already been shown, in Point I hereof, that the Commission ignored the plain language of the Act by not proceeding under subparagraph (b) of that Section. It is submitted, however, that subparagraph (b) is unconstitutional for even more reasons than subparagraph (a).

The entire argument as to the unconstitutionality of subparagraph (a) is applicable here. Subparagraph (b) fails of constitutionality for the same reasons. Both subparagraphs attempt to impose standards of rate making which entirely disregard the fundamental principles of constitutional rate making laid down by this Court. They ignore fair value and they ignore fair return.

Subparagraph (b) gives the Commission authority to fix the allowable return, and the rates which will realize this, in the amount of operating income "as adjusted" of the utility for the year 1935, or of any year subsequent thereto. The Commission is permitted to take any one year and say to the utility, wholly irrespective of whether or not the year was abnormal, unprofitable or unique because of non-recurring operating conditions, such as flood or casualty, that its return shall be no more than its operating income for that period. The Commission, in addition, may make such adjustments of the utility's reported operating income as it believes necessary and proper. Such procedure has no possible relation to the fair return on fair value to which the utility is entitled, and makes a mockery of all the existing law on valuation procedure. Confiscation again rests in the Commission's uncontrolled discretion. The authorized basis for temporary rates in this subparagraph is entirely arbitrary, and thus the subparagraph denies to the utility the essential elements of due process of law in the procedural and substantive senses, and in addition violates the Constitution of Pennsylvania.

C.

The Alternative Bases for the Prescription of Temporary Rates in Subparagraphs (a) and (b) Deny to Utilities the Equal Protection of the Laws.

The equal protection of the laws to all persons and corporations similarly situated is specifically guaranteed by the Fourteenth Amendment. The guarantee has been called "a pledge of the protection of equal laws." *Yick Wo v. Hopkins*, 118 U. S. 356, 369, (1886). Many decisions of this Court have laid down the general principles governing the nature and limits of this protection, holding that it prevents discrimination between persons similarly situated, and classification which has no substantial relation to the general object of the legislation.

In *Atchison, Topeka and Santa Fe Railroad Company v. Matthews*, 174 U. S. 96, 104-105, (1899), this Court set forth the tests which a State statute must meet in order to afford the equal protection of the laws. The Court said:

> "'Class legislation, discriminating against some and favoring others, is prohibited, *but legislation which, in carrying out a public purpose, is limited in its application, if within the sphere of its operation it affects alike all persons similarly situated, is not within the amendment.*'
>
> • • •
>
> "It is also a maxim of constitutional law that a legislature is presumed to have acted within constitutional limits, upon full knowledge of the facts, and with the purpose of promoting the interests of the people as a whole, and courts will not lightly hold that an act duly passed by the legislature was one in the enactment of which it has tran-

scended its power. On the other hand, it is also true that the equal protection guaranteed by the Constitution forbids the legislature to select a person, natural or artificial, and impose upon him or it burdens and liabilities which are not cast upon others similarly situated. It cannot pick out one individual or one corporation, and enact that whenever he or it is sued the judgment shall be for double damages, or subject to an attorney fee in favor of the plaintiff, when no other individual or corporation is subjected to the same rule. Neither can it make a classification of individuals or corporations which is purely arbitrary, and impose upon such class special burdens and liabilities. *Even where the selection is not obviously unreasonable and arbitrary, if the discrimination is based upon matters which have no relation to the object sought to be accomplished, the same conclusion of unconstitutionality is affirmed.* * * *"*

In accordance with these general principles, this Court time and again has declared invalid legislative enactments which discriminate arbitrarily.

In *Frost v. Corporation Commission*, 278 U. S. 515 (1929), a statute compelled all those applying for a permit to operate a cotton gin to prove public necessity, except certain co-operative corporations organized for the purpose of conducting, among other things, an agricultural or horticultural business. Appellant sought to enjoin the Commission from issuing a permit and prevent the corporation from establishing a cotton gin upon the ground, *inter alia*, that the exception was invalid as contravening the equal protection of the law clause of the Fourteenth Amendment. In upholding this objection the Court stated (pages 522, 523):

"The purpose of the clause in respect to equal protection of the laws is to rest the rights of all persons upon the same rule under similar circumstances. *Louisville Gas Co. v. Coleman*, 277 U. S. 32, 37. This Court has several times decided that a corporation is as much entitled to the equal protection of the laws as an individual. *Quaker City Cab Co. v. Penna.*, 277 U. S. 389, 400; *Kentucky Corp'n v. Paramount Exchange*, 262 U. S. 544, 550; *Gulf, Colorado & Santa Fe Ry. v. Ellis*, 165 U. S. 150, 154. The converse, of course, is equally true. A classification which is bad because it arbitrarily favors the individual as against the corporation certainly cannot be good when it favors the corporation as against the individual. In either case, the classification, in order to be valid, 'must rest upon some ground of difference having a fair and substantial relation to the object of the legislation, so that all persons *similarly circumstanced* shall be treated alike.' *Royster Guano Co. v. Virginia*, 253 U. S. 412, 415; *Air-way Corp. v. Day*, 266 U. S. 71, 85; *Schlesinger v. Wisconsin*, 270 U. S. 230. 240. That is to say, *mere* difference is not enough: the attempted classification 'must always rest upon some difference which bears a reasonable and just relation to the act in respect to which the classification is proposed, and can never be made arbitrarily and without any such basis.' *Gulf, Colorado & Santa Fe Ry v. Ellis*, 165 U. S. 150, 155. *Louisville Gas Co. v. Coleman, supra*, p. 37.

* * *

"Stripped of immaterial distinctions and reduced to its ultimate effect, the proviso, as here construed and applied, baldly creates one rule for a natural person and a different and contrary rule for an artificial person, notwithstanding the fact that both are doing the same business with the general public and to the same end, namely, that of reaping profits. That is to say, it produces a classification which sub-

jects one to the burden of showing a public necessity for his business, from which it relieves the other, and is essentially arbitrary, because based upon no real or substantial differences having reasonable relation to the subject dealt with by the legislation. *Power Co. v. Saunders*, 274 U. S. 490, 492; *Louisville Gas Co. v. Coleman, supra*, p. 39; *Quaker City Cab Co. v. Penna., supra*, p. 402."

In *Cotting v. Kansas City Stock Yards Co. &c.*, 183 U. S. 79 (1901), this Court held invalid an act prescribing certain regulations when a stock yard received more than 100 head of cattle or more than 300 head of hogs or more than 300 head of sheep, but exempted any individual stock yard which received less than these amounts.

After a review of the authorities on the subject, this Court stated (pages 111, 112):

"But while recognizing to the full extent the impossibility of an imposition of duties and obligations mathematically equal upon all, and also recognizing the right of classification of industries and occupations, we must nevertheless always remember that the equal protection of the laws is guaranteed, and that such equal protection is denied when upon one of two parties engaged in the same kind of business and under the same conditions *burdens are cast which are not cast upon the other*. There can be no pretence that a stock yard which receives 99 head of cattle per day a year is not doing precisely the same business as one receiving 101 head of cattle per day each year. *It is the same business in all its essential elements, and the only difference is that one does more business than the other*. But the receipt of an extra two head of cattle per day does not change the character of the business. If once the door is opened to the affirmance of the proposition that a State may

regulate one who does much business, while not regulating another who does the same but less business, then all significance in the guarantee of the equal protection of the laws is lost, and the door is opened to that inequality of legislation which Mr. Justice Catron referred to in the quotation above made. This statute is not simply legislation which in its indirect results affects different individuals or corporations differently, nor with those in which a classification is based upon inherent differences in the character of the business, *but is a positive and direct discrimination between persons engaged in the same class of business, and based simply upon the quantity of business which each may do.* If such legislation does not deny the equal protection of the laws, we are unable to perceive what legislation would."

See also:

Gulf, Colorado and Sante Fe Ry. Co. v. Ellis, 165 U. S. 150 (1896).

The prohibition against discriminatory legislation is not affected by the reserved powers of the States—the police power—since the prohibition, contained in the Federal Constitution, is the Supreme law and constitutes a limitation upon the exercise of such reserved powers.

Connolly v. Union Sewer Pipe Co., 184 U. S. 540 (1902).

Section 310(a) provides that the Commission may fix a return for a utility at 5% of the depreciated original cost of its physical property when first devoted to public use, while Section 310(b) provides that if the utility does not have continuing property records in the form prescribed by the Commission the latter may then fix a return equal to the operating income of the utility for 1935 or such subsequent year as the Commission may choose.

Under these provisions two utilities exactly the same in character, operating conditions and operating income may have different rates prescribed for them if one of them has been operating under a different bookkeeping system than that which the Commission is authorized to require. At the present time, the existence of continuing property records is purely fortuitous. Furthermore, their existence has no possible relation to the purpose of rate making, or to the elements which enter into a determination of reasonable rates.

Thus, two utilities might have property of the same fair value, the same reproduction cost, the same original cost. They might also be operating under precisely similar conditions, so that each would be entitled to the same rate of return applied to such identical fair value. Yet under the provisions of Section 310, if one of these utilities happens to have kept continuing property records, it would receive materially different treatment under the law. And this would be true regardless of the Court's construction of the provisions of subparagraph (b). If subparagraph (b) is mandatory, the unreasonable discrimination resulting from this classification is caused by the statute itself. If subparagraph (b) is merely permissive, then the Commission is granted the unlimited power to discriminate between these two identical utilities. In either case, we submit the statute is equally invalid, since it permits discrimination between corporations identically situated and uses as the test of such discrimination a factor which cannot reasonably be said to have any relation to the object of rate making or to its elements. Here, as in the *Cotting case, supra,* equal protection is denied because "upon one of two parties engaged in the same kind of business and under the same

conditions burdens are cast which are not cast upon the other."

In the *Cotting case*, the Court held that "It is the same business in all its essential elements, and the only difference is that one does more business than the other." In the instant case it is likewise the same business in all its elements, and the only difference is that one business happens to employ a bookkeeping system which the other does not.

D.

Subparagraphs (a) and (b) of Section 310 Are Not Validated by the So-Called "Recoupment" Provision of Subparagraph (e).

The Commission contends that even though it did impose rates otherwise confiscatory, their validity is saved by the so-called recoupment provisions of subparagraph (e) of Section 310. This subparagraph provides that if final rates are in excess of temporary rates the utility "shall be permitted to amortize and recover, by means of a temporary increase over and above the rates finally determined, such sum as shall represent the difference between the gross income obtained from the rates prescribed in such temporary order, and the gross income which would have been obtained under the rates finally determined, if applied during the period such temporary order was in effect." The Commission's contention is apparently based on the theory that confiscation today is constitutional so long as some kind of a provision is made for partial repayment tomorrow, even though this provision is totally silent as to the manner in which, and the time within which, repayment is to be made.

The Fourteenth Amendment to the Constitution of the United States prohibits the taking of private property without just compensation. This is the fundamental theory upon which is based judicial control of administrative agencies charged with the duty of regulating the rates of public utilities. It is at once the source of judicial power and the test of the validity of administrative action. As construed by a long line of decisions of this Court, the words "just compensation", as applied to the regulation of rates, require the allowance of a return commensurate with a fair return upon the fair value of the property of the utility used and useful in the public service. The prescription of rates allowing a return less than this amount does not provide that just compensation to which the utility is constitutionally entitled. Such a rate is confiscatory and invalid. To say that possible partial repayment tomorrow, which is guaranteed neither as to time nor amount, may remedy this deprivation of constitutional rights, is to make a mockery of the Constitution itself.

The Commission argues that such a step is necessary or convenient in the public interest. The facts in the instant case amply demonstrate the fallacy of this argument. But regardless of these facts, we submit that necessity should never be the mother of constitutional law. The adoption of a doctrine which requires or permits the construction of constitutional safeguards so as to justify even a small or temporary disregard of constitutional rights, is the first step toward a definite policy which discards the principles of democracy.

As was well said by Mr. Justice Bradley in *Boyd v. United States*, 116 U. S. 616, 635 (1886):

"It may be that it is the obnoxious thing in its mildest and least repulsive form; but illegitimate and unconstitutional practices get their first footing in that way, namely: by silent approaches and slight deviations from legal modes of procedure. This can only be obviated by adhering to the rule that constitutional provisions for the security of person and property should be liberally construed. A close and literal construction deprives them of half their efficacy, and leads to gradual depreciation of the right, as if it consisted more in sound than in substance. It is the duty of courts to be watchful for the constitutional rights of the citizen and against any stealthy encroachments thereon. Their motto should be *obsta principiis.*"

One of the latest reiterations of this doctrine is the opinion of this Court in *Jones v. Securities and Exchange* Commission, 298 U. S. 1 (1935), wherein the Court said at pages 24, 25:

"'Arbitrary power and the rule of the Constitution cannot both exist. They are antagonistic and incompatible forces; and one or the other must of necessity perish whenever they are brought into conflict. To borrow the words of Mr. Justice Day—'there is no place in our constitutional system for the exercise of arbitrary power'. Garfield v. United States, 211 U. S. 249, 262. To escape assumptions of such power on the part of the three primary departments of the government, is not enough. Our institutions must be kept free from the appropriation of unauthorized power by lesser agencies as well. And if the various administrative bureaus and commissions, necessarily called and being called into existence by the increasing complexities of our modern business and political affairs, are permitted gradually to extend their powers by encroachments—even petty encroachments—upon the fundamental rights, privileges and immuni-

> ties of the people, we shall in the end, while avoiding the fatal consequences of a supreme autocracy, become submerged by a multitude of minor invasions of personal rights, less destructive but no less violative of constitutional guaranties."

The so-called functional approach to constitutional problems is admirable. But to stretch the practical aspect of legal problems to the point at which they transcend the bounds of legal authority is a concept which has never had and should never have the sanction of this Court. Twenty years ago Dean Roscoe Pound of the Harvard Law School, in his article entitled "The Administrative Application of Legal Standards", printed in 44 American Bar Association Reports, 445 (1921), discussed in detail the functional approach to the judicial administration of justice. He pointed out the dangers of ordering society on the basis of administrative convenience. Dean Pound's approach was not from the legal precedents under a constitutional system, but was rather an historical approach from the viewpoint of individual and social ethics. He concluded that most expedients sacrifice more in justice than they secure in convenience, and do not in fact further the legal ordering of society.

So also in the realm of American constitutional law, if we apply only the test of superficial convenience and forget the general interests of society in a proper administration of law and justice, we are on the road to an administrative law which disregards that legal ordering of society—that general security—and satisfies itself with what Mr. Justice Frankfurter has aptly called "rampant empiricism".*

* Frankfurter, "The Task of Administrative Law", 75 Univ. of Pennsylvania Law Review 614 (1927).

In *Prendergast v. New York Telephone Co.*, 262 U. S. 43 (1923), the Supreme Court sustained an injunction against enforcement of an order of the New York Public Service Commission temporarily reducing the rates of the telephone company during the course of a rate investigation. The fact that the order was merely temporary in effect was held not to deprive the utility of redress. At page 49 this Court stated:

> "Nor did the fact that the orders of the Commission merely prescribed temporary rates, to be effective until its final determination, deprive the Company of its right to relief at the hands of the court. The orders required the new reduced rates to be put into effect on a given date. They were *final legislative acts* as to the period during which they should remain in effect pending the final determination; and if the rates prescribed were confiscatory, the Company would be deprived of a reasonable return upon its property during such period, without remedy, unless their enforcement should be enjoined. Upon a showing that such reduced rates were confiscatory, the Company was entitled to have their enforcement enjoined pending the continuance and completion of the rate-making process. *Cumberland Telephone & Telegraph Co. v. Louisiana Commission, supra.* And see, by analogy, *Oklahoma Natural Gas Co. v. Russell, supra;* and *Love v. Atchison Railway Co.* (C. C. A.) 185 Fed. 321, 326 (affirming 174 Fed. 59, and 177 Fed. 493)."

The due process clause, in prohibiting the taking of property without just compensation, makes no distinction between temporary confiscation and permanent confiscation. Thus, in principle, a confiscatory rate may not be sustained merely because it is not to be continued in effect forever. For every day of its continuance there is a constant taking of property without just compensation.

In *Laclede Gas Light Co. v. Public Service Commission of Missouri*, 8 Fed. Supp. 806 (D. C. W. D. Mo., 1934), the Court in treating with this proposition said (p. 809):

> "It is earnestly urged by defendants and intervenor that the Commission's order should be permitted to go into effect because it is intended only to be temporary. But, as we have pointed out, the order itself is not so limited. Moreover, *the constitutional prohibition against the taking of property without due process of law contains no exception permitting a taking of some property or a taking during a limited period of time.*"

In *Love, et al., v. Atchison, Topeka & Santa Fe Ry. Co.*, 185 Fed. 321 (C. C. A. 8th, 1911), an injunction was granted against an order reducing passenger and freight rates of the railway company. It was contended that the suit was prematurely brought because the rates complained of were imposed merely during the continuance of a rate investigation, at the termination of which a final rate was to be fixed. The Court held this contention to be unsound, stating, at page 327:

> "The legislative function in rate making looks to the future and determines what future rates shall be. But when rates, either tentative or final, have been put and are maintained in actual operation under penalty of severe fines, the question whether or not their effect is to take the property of the railroad companies affected thereby without just compensation is a judicial one, conditioned by past or present facts, and the national courts cannot be deprived of jurisdiction of it by the fact that the process of making the tentative rates is yet incomplete. *It is as clear a violation of the constitution, and one as promptly remediable in the national courts, to take the property of a railroad company without just com-*

pensation by the enforced operation of tentative rates during the process of their making, as by the operation of final rates after the process is complete.''

In *Mountain States Tel. & Tel. Co. v. Utah Public Utilities Commission*, 8 Fed. Supp. 307 (D. C. D. Utah, 1934), in considering the asserted temporary character of a rate reduction order, the Court said, in granting an injunction (at p. 310):

> ''It is further contended for the commission that its order should be regarded as temporary and would probably be modified at the conclusion of the statewide inquiry. The order itself made the reduction 'pending the further hearing and determination of this case and until the further order of the commission'. But if the order is not stayed it will take effect as of last April, the statewide inquiry will not be resumed until next October, *and confiscation will go on.* United Railways v. West, 280 U. S. 234, 249.''

It is argued that under the Pennsylvania law there can be no taking of property because of the recoupment provision of Section 310 (e). But clearly the loss occasioned to the complainant by fixing confiscatory temporary rates cannot be fully compensated for by fixing rates in the future in excess of the current legal requirements.

In *Oklahoma Natural Gas Company v. Russell, et al.*, 261 U. S. 290 (1923), Mr. Justice Holmes, writing for this Court, said (page 293):

> ''Coming to the principal question, if the plaintiffs respectively can make out their case, as must be assumed for present purposes, they are suffering *daily* from confiscation under the rate to which they now are limited. They have done all that they can under the state law to get relief and cannot get it. If the Supreme Court of the State hereafter shall

> change the rate, even *nunc pro tunc*, the plaintiffs will have no adequate remedy for what they may have lost before the court shall have acted." (Citing with approval *Love v. Atchison, T. & Santa Fe R. Co., supra*, and *Springfield G. & E. Co. v. Barker*, 231 Fed. 331 (D. C. W. D. Mo., 1915.))

The argument that future recoupment might compensate present loss was rejected by the Court in *Springfield Gas & Electric Co. v. Barker, supra*, at page 335, as follows:

> "A sufficient answer to this argument is found in the fact that consumers of electricity are constantly changing, and that additional charges could scarcely be enforced against those who had not enjoyed the lower rate."

That a provision for recoupment of losses due to confiscation during the effective period of a temporary rate cannot be fully compensatory is inherent in the nature of the immeasurable, as well as irreparable, damages which may be incurred by the utility during the operation of the temporary rate. This becomes very evident by the application of the dialetical principle *of reductio ad absurdum* to the theory that future recoupment is just compensation for present confiscation. If this theory is sound as applied to rate making, then a temporary rate might be imposed which was inadequate to yield a return equal to the cost of operation and maintenance,—outrageously confiscatory—but yet justly compensable by a permanent rate providing future recoupment—of necessity outrageously high. Under such circumstances, can it conceivably be argued that the damage to the utility, to its security holders, and to the public, from the drastic confiscation and the disability to perform its public service, could be justly compensated

by any provision for future recoupment? If the confiscation is not so drastic, the difference is merely in degree, not in principle. It is no answer to say that a little uncompensated confiscation may be all right; for constitutional safeguards are not so framed as to countenance some degrees of violation, and to prevent others.

(a) The so-called "recoupment" may never operate at all, in which case the "temporary" confiscation becomes permanent and final.

The Commission is attempting to do *indirectly* that which it cannot constitutionally do *directly*. Admittedly the Commission could not legally prescribe final confiscatory rates. However, the appellants argue that a temporary confiscation is constitutional, compensation being afforded by subparagraph (e) of Section 310.

It is patent, therefore, that the constitutionality of the Commisson's power to impose temporary rates is dependent upon: first, the temporary character of the rates and, second, the existence of adequate recoupment. Analysis of this suggested regulation clearly demonstrates its unconstitutional results. It must be conceded that if there is *any element of finality* in the confiscatory rates authorized under Section 310 then such rates must fall, as a permanent rate not affording a fair return on the fair value of a utility's property cannot stand.

Subdivision (e) purports to provide recoupment to the *utility*. If the temporary rate yields less than a fair return, it is the property of the *utility* which is taken. If the recoupment provision of subdivision (e) is to provide the just compensation which avoids confiscation, then that just compensation, that recoupment, must be

certain, and assured to the one which has suffered the loss to be recouped. That one only, under the statute, and as a matter of simple fact, is the utility.

But in reality there is no assurance of recoupment to the utility which suffers the "temporary" loss, and this for a number of reasons:

(1) The properties of utilities which are part of holding company systems, (and the appellee is one) may likely be subject to sale in order that the so-called integration provision of paragraph 11 of the Public Utility Holding Company Act may be complied with. If a utility sells its property with a temporary rate in effect, and the final rate thereafter fixed is greater than the temporary rate, obviously, under the statute, for the period of the temporary rate before the property was sold, there is an admitted taking of the utility's property, its fair return, to the extent that the temporary rates were less than the final rates. This taking, in order not to be out-and-out confiscation, must be compensible. Yet the *utility*, the only one under the statute entitled to compensation, then no longer has property, no longer has customers, is no longer rendering service. The recoupment provided for by statute is impossible to even a slight extent.

Since recoupment is in its very nature the making up of a loss to one who has suffered it, the property itself, which has been transferred, is not entitled to the increased rate. Nor is the transferee of the property, who has lost nothing by the temporary rate, entitled to recoupment, either as a matter of law under the statute, nor as a matter of simple justice and equity.

The utility which has suffered the loss has suffered it irretrievably. It cannot recoup. For it the confiscation of its property is complete and final.

(2) The "temporary" confiscation may be so drastic as to disable the utility from existing until the time of recoupment is reached. Particularly is this true when the time of recoupment is uncertain. The utility may very well have become bankrupt before it receives the "just compensation" by way of recoupment.

(3) All or part of the property of the utility may be destroyed during the pendency of the confiscatory rates, so that the utility will not be able to render the service necessary to provide it with "recoupment".

(4) The so-called recoupment provision may not be in existence when the final rate is fixed. There is nothing to prevent the Legislature of Pennsylvania from repealing this section after a temporary rate has become effective, but before the final rate is fixed. Since the utility has no vested rights under the statutes, it could have no legal complaint based on its repeal. In such a case, its property would have been confiscated without even the hope of just compensation. Even so, it would have no constitutional remedy for this unconstitutional act. In *Bluefield W. W. & Improvement Company v. P. S. C., supra,* at page 694 the Court remarked on—

> "The fact that the company may not insist, *as a matter of constitutional right,* that past losses be made up by rates to be applied in the present and future tends to weaken credit and the fact that the utility is protected against being compelled to serve for confiscatory rates tends to support it."

(b) Recoupment may not be adequate to provide "just compensation."

(1) Even though the utility is not rendered insolvent, its financial condition may be seriously injured by "temporary" confiscation. The exact extent in dollars to which it may be damaged is in the nature of things, incapable of measurement. Yet it must be obvious to any person having any familiarity with the financing of utility enterprises that a utility's credit may be seriously impaired by a temporary blot on its financial standing. Certainly its ability to attract capital will be lessened, and this, to a utility, is vital if it is to continue its public service and to extend it as required by the normal growth of the territory it serves (see *Bluefield W. W. & Improvement Co. v. P. S. C., supra*).

(2) The utility may, because of impaired credit standing, be required to pay a higher interest rate for money even if the confiscation due to the temporary rate is not so great as to render it totally unable to attract necessary capital. The loss to the utility in this instance is one which cannot be compensated by a future recoupment of its loss in income.

(3) The temporary rate may well be such as to prevent the utility from properly maintaining its property. In such event a recoupment at a future time of the difference in dollar income could never be fully compensatory. It invariably costs more to make repairs long after they become necessary than it would have cost at the time they should have been made.

These factors and their reality were fully explained in the testimony of Mr. George Knutson, a utilities financial expert (R. 1078).

(c) Even assuming that, theoretically, a provision for complete recoupment of all damages might be devised which would provide just compensation in the future for a present taking of property, nevertheless, the provisions of Section 310 (e) do not accomplish this purpose, and therefore, cannot be relied on to validate an otherwise unconstitutional statute.

At the outset of a consideration of these provisions, it is important to note that the Commission has only limited powers—those given to it by the Public Utility Law. It cannot enlarge them. It cannot itself legislate so as to expand the presently existing provisions of the Public Utility Law to a theoretically perfect state. For this reason we must consider only the provisions of Section 310(e) as they now exist, rather than a possibly more complete or adequate recoupment provision which the Legislature of Pennsylvania might have enacted into law, but which the Commission is and will be powerless to consider. The recoupment provision as it now stands is not only inadequate but wholly illusory.

(1) *Section 310 (e) does not guarantee to the utility that it will ever receive just compensation for the taking of its property, nor does it offer any security whatever for the payment of this just compensation.* The utility must rely solely on the future legislative action taken by the Commission when the final rate is fixed. Yet it has uniformly been held that the ascertainment and payment of just compensation for the taking of property is a constitutional necessity.

The decisions in cases involving the taking of property by eminent domain furnish a complete analogy, and are recognized as applicable to the rate making process.

In *West v. Chesapeake & Potomac Tel. Co.* (supra), it was stated (at page 671):

> "The established principle is that as the due process clauses (Amendments five and fourteen) safeguard private property against a taking for public use without just compensation, neither Nation nor State may require the use of privately owned property without just compensation. When the property itself is taken by the exertion of the power of eminent domain, just compensation is its value at the time of the taking. So, where by legislation prescribing rates or charges the use of the property is taken, just compensation assured by these constitutional provisions is a reasonable rate of return upon that value."

At the outset it is recognized that there may be a taking of property for which compensation is not immediately made. However, where the compensation is postponed, it is held that the legislature itself must provide for the ascertainment of the amount of the compensation and must in some way guarantee its payment.

Thus, in *Bloodgood v. Mohawk & Hudson Railroad Company*, 18 Went. (N. Y.) 9, 17 (1831), Chancellor Walworth held:

> "But it certainly was not the intention of the framers of the constitution to authorize the property of a citizen to be taken and actually appropriated to the use of the public, and thus to compel him to trust to the future justice of the legislature to provide him a compensation therefor. The compensation must be either ascertained and paid to him before his property is thus appropriated, or an appropriate remedy must be provided and upon an adequate fund; whereby he may obtain such compensation through the medium of the courts of justice if those whose duty it is to make such compensation refuse to do so."

It has been held that no remedy or guarantee of payment is appropriate unless the credit of the political government which is taking the property is pledged to secure such payment.

In *Liberty Central Trust Co. v. Greenbrier College* (D. C. S. D. W. Va., 1931) 50 Fed. (2d) 424, 429, affirmed 283 U. S. 800 (1931), the Court said:

> "Of course, the payment of the award must be insured, and it is held that the full faith and credit of the political division involved must be pledged to the payment. Sweet v. Rechel, 159 U. S. 401, 20 Corpus Juris, 651, 652."

Similarly, it has been held that a remedy which is limited to certain specified property is inadequate. Thus, in *Sage v. City of Brooklyn*, 89 N. Y. 189 (1882), 195-6, it was stated:

> "It is, I think a plain proposition, that a law authorizing the taking of a man's land, and remitting him for his sole remedy for compensation to a fund to be obtained by taxation of certain specified lands in a limited district, according to benefits, is not a sure and adequate provision, dependent upon no 'hazard, casualty or contingency whatever', such as law and justice require to meet the constitutional requirement."

Manifestly, Section 310(e) does not conform to the constitutional standard of just compensation. It provides no fund for the guarantee of recoupment, no appropriate remedy for its collection, no enforcible right cognizable in courts of justice to compel payment. It does not pledge the credit of the Commonwealth of Pennsylvania or of any political government to the payment of the just compensation which recoupment is supposed to afford. It does not even provide any defined remedy,

and the utility is remitted for its payment to an undefined and presently anonymous group of individual consumers who in the future, when a permanent rate is fixed, may be on its lines. The utility is thus relegated to the doubtful financial responsibility of private corporations and individuals. This surely is not a guarantee of payment.

(2) *Even the limited rights of utilities to enforce payment are severely restricted, both by economic conditions and constitutional limitations.* To the extent that there is any such right, it is solely against future customers who, according to Section 310(e), are to repay the utility a portion of the loss suffered by reason of compulsory benefits to previous consumers. However, these future consumers cannot be compelled to make good the loss. Economic conditions at the time recoupment is to be had may be such as to reduce normal consumption. There is no power on earth, legal or otherwise, which can compel customers to use a given amount of electricity, much less an amount which would be required to be used at the increased rate fixed in accordance with subparagraph (e). Clearly, the company has no right of action against them, nor any vested right whatever to the just compensation to which it is entitled.

Viewed from a legal standpoint, the plight of the utility is even worse. It is established by the record in this case (Appellee's Exhibit E, R. 1108-1111), and indeed it is an obvious fact, that customers change constantly. Presumably then, the increased rate to provide recoupment must be paid in part by those who never had the benefit of the low temporary rate. As a consequence, an order increasing the rates of these customers above a reasonable rate would be grossly

discriminatory. *Such an order would violate the provisions of Section 304* of the Pennsylvania Public Utility Law itself, which expressly prohibits such discrimination.* Clearly, these customers who have thus been discriminated against would have a valid objection to the so-called recoupment rates. And if it be said that the Public Utility Law permits such discrimination, it is more than likely that such a law would be declared unconstitutional as depriving these customers of the equal protection of the laws by an unreasonable and unwarranted discrimination.

In short, the utility has no vested right under Section 310 (e) against anyone, solvent or insolvent, named or anonymous, for the collection of the so-called recoupment, and to some extent at least such powers of collection as are granted to the utility are clearly invalid.

This defect is not remedied by the Commission's argument that the Appellee cannot raise the question on behalf of the injured consumers. The Appellee is raising the question solely on its own behalf—since if the consumers can prevent the imposition of the recoupment rate, it is the Appellee who will be injured. It can never recoup.

(3) *The measure of recoupment* provided by subparagraph (e) is limited solely to the difference between gross income obtained from the temporary rate and gross income which would have been obtained from the rates finally determined if applied during the period that the temporary order was in effect. This measure *is wholly inadequate.*

No provision whatever is made for credit impairment resulting from the temporary confiscatory rate. No pro-

* Printed in full in Appendix A hereof.

vision whatever is made for loss of ability to attract capital resulting from the temporary confiscatory rate. *Not even is there provision made for loss of interest on the return to which the utility was rightly entitled and of which it was deprived by the temporary rate.* Significantly, where the reimbursement is to be made by the utility, interest at the legal rate is specifically provided. Thus, under Section 313 of the Public Utility Law,* if the Commission finds that a utility has been exacting an unreasonable rate, the utility may be required to refund the amount of any excess paid "together with interest at the legal rate from the date of each such excess payment." *Not only is there no provision for interest from the time of institution of confiscatory temporary rates until recoupment is awarded, but there is no provision for interest on the unamortized portion of the recoupment during the recoupment period.*

(4) *Section 310(e) makes no provision for either the time or the rate of recoupment.* This in itself makes recoupment wholly illusory. If a high rate of recoupment over a short period of time is provided for in the final rate order, this necessarily means that the rates to be charged during the period will be excessive. Such an excessive rate would discourage the use of electricity, and the result of the decreased use would be the yield of a smaller return than would be received at the normal or fair rate. There would result in this situation not only a decreased use, but a loss of customers as a result of competition. Particularly would this be true in the case of large power users, where the difference of a few mills per k. w. h. in energy costs is often sufficient to gain or lose a power contract and a power customer.

* Printed in full in Appendix A hereof.

The provision for recoupment, of course, does not undertake to compensate for such losses, which would be the direct, if delayed, result of "temporary" confiscation. Nor does Section 310 (e) suggest the manner in which the excess or recouping rates are to be allocated among the various classes of consumers. What proportion is to be borne by power users where the temporary rates have benefited domestic consumers? This is but one of a veritable flood of serious operating questions unanswered by subparagraph (e).

If, on the other hand, the period of the amortization of recoupment is lengthy and the rate small, this in itself may amount to confiscation. In *Smith v. Illinois Bell Tel. Co.*, 270 U. S. 587 (1926), the Court said, at page 591:

> "* * * Property may be as effectively taken by long-continued and unreasonable delay in putting an end to confiscatory rates as by an express affirmance of them; and where, in that respect, such a state of facts is disclosed as we have here, the injured public service company is not required indefinitely to await a decision of the rate-making tribunal before applying to a federal court for equitable relief."

Under Section 310(e), the order fixing the final rate must prescribe the amount of the recoupment and the period of amortization. The amount is thus fixed. Nevertheless, to the extent that this sum is not repaid at any time after the date of the final order, the confiscation continues, *and for this new and added confiscation no remedy at all is afforded.*

(5) No provisions are made for the fluctuations in the purchasing power of the dollar and thereby no consideration is given to, or allowance made for the difference in the purchasing value of money between the date of pre-

scription of temporary rates and the date of fixed permanent rates.

Because, therefore, Section 310(e) makes no guarantee or assurance of the payment of the limited recoupment provided for, because that recoupment is wholly inadequate, and because, finally, for the reasons above stated, even the limited and inadequate recoupment is wholly illusory, the provisions of Section 310(e) do not provide for just compensation in the future for a present taking of the utility's property. The provisions of Section 310(e) are therefore wholly insufficient to validate an otherwise confiscatory temporary rate order. As stated by the Supreme Court in *West Ohio Gas Co. v. Public Utilities Commission of Ohio*, 294 U. S. 79, 83 (1935):

> **"Present confiscation is not atoned for by merely holding out the hope of a better life to come."**

With respect to these unanswerable legal and practical arguments, the Commission's brief is silent. The Commission relies entirely upon the case of *Bronx Gas & Electric Company v. Maltbie*, 271 N. Y. 364 (1936). That case sustained the constitutionality of Section 114 of the New York Public Service Law, which provided for the imposition of a temporary rate sufficient to provide a return of not less than 5% on original cost less accrued depreciation, and authorized the Commission, in any proceeding in which temporary rates are fixed, to consider the effect of such rate in prescribing the rates thereafter to be charged on final determination of the rate proceeding. It was conceded by the Commission, and found by the Court, that the temporary rate under attack, had it any element of finality, would be confiscatory. It was

also conceded by the Court that because the elements in rate-making prescribed by the Supreme Court in *Smyth v. Ames, supra,* and thereafter were not considered in making a temporary rate, such rate, if final, would be unconstitutional and void. However, the Court construed the provision authorizing the Commission, in fixing a final rate, "to consider the effect" of the temporary rate, as making recoupment mandatory if the final rate were higher than the temporary rate, and as so construed, held that the provision for a future recoupment amounted to just compensation for property presently taken.

To the extent that this decision sustains a confiscatory temporary rate, or one fixed without regard to procedural due process of law, even if it provides for future recoupment, the Appellee submits it is plainly not good law. This is true first, because it justifies the substitution of expediency for the fundamental principles of justice and law, and second, because as a matter of expediency, it is unsound, in that it sacrifices the important interests of society in the proper and efficient functioning of persons and corporations engaged in supplying a public necessity, to the temporary and superficial expediency and convenience of regulatory commissions.

In view of the serious injury which may be caused to the utility by even a temporary confiscation of its property, and in view of *the even more serious injury which may be caused to constitutional democracy by the approval of a deliberate disregard of constitutional rights*, we submit that the superficial convenience of administrative bodies should not thus be served. The Appellee believes it perfectly possible for a realistic Commission to regulate the rates of utility companies with-

out depriving them of their legal rights. The instant case itself shows no necessity for a disregard of these legal rights. Commission's counsel has conceded that no effort was made to impede or prolong the rate proceeding. It was neither long nor particularly involved. Indeed, when the first rate order was made the Commission had all the evidence before it on which it could issue a final order.

Moreover, the *Bronx Gas* case presented a situation materially different than the instant case. There a statute, which was very broad and equally vague, was construed by the highest court of the state as making full and complete recoupment mandatory. This construction, of course, was the final judicial word upon the meaning of that recoupment provision. In the instant case we have a more limited and more specific provision. It has not been construed by the highest court of Pennsylvania. Taken as it stands, it clearly does not provide full and complete recoupment for the reasons outlined above. As a consequence, it cannot be assumed that complete recoupment will be afforded. On the contrary, in view of the limited powers of the Commission, it must be held that such recoupment cannot be afforded. For these reasons, we submit that the *Bronx Gas case*, even if it were sound law, would not justify a similar holding here, and that for the reasons heretofore discussed, the provisions of Section 310(e) are wholly inadequate to validate the otherwise unconstitutional provisions of Section 310(a) and (b).

POINT III.

THE ORDER OF THE COMMISSION CONTRAVENES THE FOURTEENTH AMENDMENT TO THE FEDERAL CONSTITUTION BECAUSE IT IS BASED ON FINDINGS NOT SUPPORTED BY SUBSTANTIAL EVIDENCE AND BECAUSE THE RATES IMPOSED BY IT ARE CONFISCATORY.

A.

THE COMMISSION DEPRIVED THE APPELLEE OF THE ESSENTIAL REQUIREMENTS OF PROCEDURAL DUE PROCESS OF LAW.

Numerous decisions of this Court enunciate the well established principle that in a rate proceeding a public utility is entitled to a fair hearing, an opportunity to introduce evidence, and *a judgment according to the evidence*. It is also settled law that a utility is entitled to earn a fair return on the fair value of its property used and useful in the public service, and that among the elements which must be considered in a determination of fair value are reproduction cost new, reproduction cost new less accrued depreciation, original cost, going concern value and working capital. *Smyth v. Ames; St. Louis & O'Fallon R. Co. v. United States; Los Angeles Gas & Electric Corp. v. Railroad Comm.; West v. Chesapeake & Potomac Tel. Co.* and *Railroad Comm. of Cal. v. Pacific G. & E. Co.* (all *supra*).

Not only must the foregoing elements be considered in a determination of fair value, but the record must disclose substantial evidence to support such determination. Likewise the record must exhibit the facts relied upon by the Commission to disregard or ignore unimpeached evidence submitted by the Company. In *West*

Ohio Gas Co. v. Ohio Public Utilities Comm., supra, the Court, at pages 68-69, said:

> "To make such review [referring to a judicial review of an order of the Ohio Commission] adequate the record must exhibit in some way the facts relied upon by the court to repel unimpeached evidence submitted for the company. If that were not so, a complainant would be helpless, for the inference could always be possible that the court and the commission had drawn upon undisclosed sources of information unavailable to others. *A hearing is not judicial, at least in any adequate sense, unless the evidence can be shown.*"

To the same effect is *Ohio Utilities Co. v. Ohio Public Utilities Commission, supra,* and the more recent *Railroad Comm. v. Pacific Gas & Electric Co.,* 302 U. S. 388, (1938), in which this Court, in its opinion, said:

> "'In the instant case, we cannot say that the commission in taking historical cost as the rate base was making a finding without evidence and therefore arbitrary.
>
> "The decisions cited by respondent do not require a different conclusion. In Northern Pacific Railway Company *v.* Department of Public Works, 268 U. S. 39, 43-45, we said that the commission's action in reducing rates by an order dependent wholly 'upon a finding made without evidence' or 'upon a finding made upon evidence which clearly does not support it' in the face of unchallenged evidence of probative value showing that the rates were already confiscatory was an arbitrary act and a denial of due process."

Having in mind the established law, it is clear from an analysis of the testimony and evidence constituting the record in the instant case that the Commission not

only failed to give consideration to certain necessary elements of fair value, but that it relied upon and adopted evidence having no probative value in preference to substantial and unimpeached evidence submitted by the Appellee. The following discussion relating to the various elements of fair value will demonstrate this fact.

Present Cost of Construction.

The testimony and exhibits introduced by the Appellee relating to the present cost of construction of its property, were based upon a physical examination and count in the field of the actual units of property in place and classified in accordance with their appropriate account numbers or classification, as designated by the Uniform Classification of Accounts prescribed by the Commission (R. 492-494).

The estimate of the reproduction cost new as of November 30, 1936 was $5,572,134 and the estimate of the reproduction cost new less accrued depreciation as of the same date was $4,950,609 (R. 629). Subsequently, such estimates were revised by translating them into prices prevailing as of June 1, 1937 to show the extent to which the original estimates had been affected by rising prices between November 30, 1936 and a date more nearly coincident with the termination of the rate proceeding. The revised estimate of reproduction cost new as of June 1, 1937, was $6,019,832 and the revised estimate of depreciated reproduction cost as of the same date was approximately $5,350,000 (Appellee Exhibit 18, R. 1030). The uncontradicted evidence in the record further discloses that between November 30, 1936 and September 30, 1937, Appellee constructed net additions to its plant and property at an actual cost to it of $142,851.07 (Appellee's Exhibit 22, R. 1037-1038).

The Commission, *electing to ignore the uncontradicted evidence of the Appellee with respect to the increase in the reproduction cost of its property between November 30, 1936 and June 1, 1937, and further to ignore the aforementioned expenditure by appellee of $142,851 for net additions between November 30, 1936 and September 30, 1937,* found in its order that the reproduction cost new of appellee's property was $5,293,064, and that the depreciated reproduction cost was $4,737,803 (R. 21, 28-29). This arbitrary reduction in the estimated reproduction cost of the property of Appellee as of November 30, 1936, was based solely on a reduction of $212,807 in the property embraced within the accounts covering general overheads, a reduction supported only by the testimony of L. C. Bierman, a member of the engineering staff of the Commission (R. 215-231, 293-297).

Before pointing out that there is no proper basis for such a reduction in general overheads, the Court's attention is respectfully addressed to its decision in *McCart v. Indianapolis Water Company,* 302 U. S. 419 (1938), wherein it was held that a valuation based on prices as of 1933 was invalid to support a finding of value as of 1935. Hence, it follows that the action of the Commission in refusing to recognize an actual increase in prices between November 30, 1936 and June 1, 1937, as well as its refusal to make any allowance for actual net additions to property between November 30, 1936 and September 30, 1937, is arbitrary and unlawful.

The aforementioned reduction in general overheads is unsupported by substantial evidence. Commission's witness Bierman testified (R. 457, 958) that he *had not made a personal inspection or appraisal of Ap-*

pellee's property and had formed no independent opinion as to its reproduction cost. Thus the witness sought to determine the proper overheads to be added to the reproduction cost of the physical property without any actual knowledge of such property or judgment as to its reproduction cost. Clearly, such testimony cannot be regarded as "substantial evidence", and the Commission in accepting it in lieu of that of witnesses for the Appellee made precisely the same sort of error as that of the Ohio Commission in *Ohio Utilities Co. v. Ohio P. U. C., supra,* which was condemned by this Court.

It is true that the Commission endeavored to find support for this arbitrary treatment of general overheads by reference in its order (R. 20-21) to the opinions of the Superior Court of Pennsylvania in *Chambersburg Gas Co. v. Public Service Commission, supra,* and *Cheltenham & Abington Sewerage Co. v. Public Service Commission,* 122 Pa. Superior Ct. 252 (1936). These cases involved two small public utilities, one a gas and the other a sewerage company, wherein the Court happened to approve smaller allowances for general overheads than the Commission has allowed Appellee in the instant case. It is obvious, however, that overheads of a small gas company or a sewerage company can not be applicable to an electric company. Such a reasoning plainly ignores the evidence in the instant case. Clearly the allowances appropriate for such overheads are not to be determined by a formula or a rule of thumb, but are governed by evidence of the circumstances relating to the particular inquiry in question, such as the time of the construction, the experience of the particular utility and the value of its property. Complainant's evidence is the only such evidence in this case. To reject it is to "repeal unimpeached evidence

submitted for the Company." *West Ohio Gas Co. v. Ohio Public Utilities Commission, supra.*

That the determination of overheads is not a matter of formula but one dependent upon the facts and circumstances in the particular case is recognized by the American Society of Civil Engineers at page 1562 (Appendix III) of a document entitled "Report of the Special Committee" of that body, wherein, during the course of a discussion relating to such overheads, it is observed:

> "In presenting these data as to actual overhead costs, the Committee desires to lay stress on the need of using all such figures with caution. Items entering into overhead cost of different and similar works *are rarely alike*, and many of the expenses, and even classes of expense incurred on one piece of work, might not be incurred on another."

There is nothing in the record herein, including the Commission's opinion, to indicate the slightest similarity between indirect costs which would be incurred in the reproduction of Appellee's property and those incurred by the aforementioned gas company or sewerage company. The adoption of the overheads approved by the Superior Court of Pennsylvania in the instances relating to the two last mentioned companies as a proper allowance for the Appellee is a finding unsupported by logic or valid reason.

From all of the foregoing it is submitted that there is no substantial evidence to justify the action of the Commission in reducing by the sum of $212,807 the Appellee's estimate of the reproduction cost new of its property as of November 30, 1936, or in further reducing by the same sum the Appellee's estimate of the depreciated reproduction cost of its property, where the only

basis for such reduction is the testimony of a witness who has never inspected the property or formed any independent judgment as to its value. Furthermore, in its findings with respect to reproduction cost, the Commission has failed to give *any* consideration to (1) net additions to Appellee's property, and (2) the reproduction cost of such property as of a date substantially coincident to the date of its order.

It follows that the estimates of the reproduction cost of the property of Appellee, as submitted in its behalf, should have been adopted by the Commission and that there is no substantial evidence to support the Commission's finding of reproduction cost.

The Commission, in its brief, attempts to support this arbitrary action by a combination of inaccurate statements and erroneous conclusions. First it states at page 58, that additional deductions for depreciation from November 30, 1936 to September 30, 1937 would equal the net additions. It then states at page 59, that the reproduction cost estimate revised to include changes in prices to May 31, 1937 made no deductions for depreciation—and further that the Appellee still regarded $5,500,000 as the fair value of its property.

These claims are most misleading. Assuming that the increase in the reproduction cost estimate, due to net additions to the Appellee's property, is counterbalanced by additional deductions for depreciation, it is still true that the Commission's finding of depreciated reproduction cost wholly fails to give effect to increases in prices from the date of the Appellee's original reproduction cost estimate (November 30, 1936) and a date near the termination of hearings (May 31, 1937). The original

estimate of reproduction cost new as of November 30, 1936 was approximately $5,570,000 (R. 1020). The estimate based on prices as of May 31, 1937 was approximately $6,000,000, an increase of $430,000 (R. 1030). Applying this increase to the estimate of depreciated reproduction cost as of November 30, 1936 of $4,950,000, we find that a reasonable estimate of depreciated reproduction cost (eliminating both net additions and the equivalent deductions for additional depreciation) is $5,380,000. Even if we deduct from this figure that portion of the allowances for general overheads which was eliminated by the Commission, the estimate is $5,168,000. This figure is more than $430,000 in excess of the Commission's finding of depreciated reproduction cost of $4,737,803.

It is not true that the Appellee claimed a fair value of only $5,500,000. No such claim was made in the complaint. The affidavits referred to by the Commission stated that the fair value was not less than $5,500,000, and that proper consideration of additional factors, such as net additions, would increase this figure (R. 4-57).

Original Cost.

The estimate of the original cost of the property of Appellee used and useful in its public service as of November 30, 1936, was $4,969,000. This amount has been increased by the aforementioned net additions from November 30, 1936 to June 30, 1937 in the sum of $142,851.07. For the purpose of determining such estimate of original cost, the actual costs of materials and labor experienced by the company, as of the respective dates of installation, were adopted and the same applied to the inventory of Appellee's property as of November 30, 1936. In such instances where the books failed to disclose such

actually experienced costs, prices of materials prevailing as of the particular dates of installation, and prevailing costs of labor in York, Pennsylvania as of the date of such installations, were applied (R. 492-493, 504-512, 517-527, 544-548).

In its order, the Commission, in making its determination of the original cost of the property of Appellee, accepted substantially its estimate, as of November 30, 1936, less an item therein in the sum of $349,880 for cost of financing. *The Commission then further deducted the sum of $506,000, representing purported depreciation and arbitrarily refused to make any allowance for the aforementioned net additions* (R. 23).

The Commission eliminated the item of cost of financing, on the theory that "respondent's evidence nowhere indicates that any studies were ever made of such cost" (R. 22). In this the Commission erred. The estimate for this item was based, among other things, upon a study of Appellee's experience. Reference to Appellee Exhibit No. 1 (R. 1017), which includes a chart portraying the cost of money experienced by York Railways Company (the parent of complainant), from 1909 to 1925, and the distribution of the proceeds realized from the sale of its securities, demonstrates that $2,407,175 was realized from the sale of 6% bonds in the principal amount of $2,706,000, and that the aggregate discount was $298,825. It is, therefore, apparent that the **experienced** cost of financing of Appellee's parent over the period in question and for the securities mentioned was something in excess of 11%, or approximately 3½% *in excess of the estimate of the cost of financing included in Appellee's original estimate.* The exhibit further shows that of the proceeds of $2,407,000, the sum of $1,027,000 was actually expended for construction of the property of Appellee. It is

inescapable that the cost of financing the Appellee, had it been required to raise its necessary capital requirements through the public sale of securities, would have been at least equivalent to that actually experienced by its parent in raising funds for the appellee. It is clear that during the years mentioned above, the parent company was a prosperous corporation with a far better credit standing than that of Appellee, and that during the earlier years its business was less speculative in character than that of Appellee.

The Commission's action, therefore, in disallowing known cost of financing and failing to make any allowance for undisputed net additions, was erroneous. There remains for consideration the propriety of its action in depreciating original cost.

No attempt was made by Appellee to depreciate the original cost of its property, because such cost represents the actual investment made by Appellee and is not subject to depreciation. Even though the property should ultimately disappear, the amount originally expended to create it would remain the same. Hence, there is no computation that can be made which would indicate that the amount of the investment is at any time less than that originally put into the property.

The Commission's action in depreciating original cost is also inconsistent with the position taken in its brief that prudent original cost should replace fair value as the constitutional standard of rate-making. If such original cost, as distinguished from value, is used as the rate base, it must be on the theory that the owners of a utility are constitutionally entitled to a return on the money pru-

dently invested by the first owners of the business. This amount can never depreciate, and any attempt to reduce it by depreciation would, under the Commission's own argument, deprive the present owners of their property without just compensation. (See opinion of Brandeis, J., in the *Southwestern Bell Telephone Case, supra.*)

In attempting to make a computation of depreciated original cost however, the Commission applied a percentage to Appellee's original cost estimate equal to the average of depreciation as determined in the latter's reproduction cost estimate (R. 23). Appellee's accrued depreciation amounted to $621,524, which happened to be 11% of the estimated reproduction cost new. This percentage was merely the weighted average of the depreciation, as determined for the various units of property. The Commission, for the purpose of determining the so-called depreciation of original cost, deducted from such cost a sum equivalent to 11% thereof. Such a computation is clearly erroneous, not only because original cost cannot be depreciated but for the further reason that the property of Appellee was built over a long period of time at various price levels. The accrued depreciation for the reproduction cost which produced the weighted average of 11% was, on the other hand, based upon an established price level, and hence the use of that percentage in connection with original cost is fallacious.

By way of illustration of this erroneous computation, property embraced within two account classifications "General Office Structures", Account No. 278, and "Other General Structures", Account No. 279, may be taken as examples. The weighted average depreciation for the property in these two accounts in Appellee's Exhibit No. 9 (R. 1021) (being the estimate of re-

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production cost new) is 12.3%. If the same percentages of depreciation, forming a part of the weighted average, is applied to the same two accounts in the original cost estimate, the weighted average of depreciation would become 13.5%, thus demonstrating the fallacy of the Commission's application of the percentages of depreciation derived in connection with reproduction cost estimates, to original cost.* If the comparison had been based on individual units of property instead of whole accounts, the disparity would be even greater.

In further considering the manifest impropriety of the Commission's action in depreciating original cost, it should be said that there is not only an absence of *substantial* evidence, but there is *no* evidence in the record dealing with *any* suggested method of depreciating such cost. This lack of evidence is no doubt due to the

* It will be noted from the following computation that if the percentages of depreciation derived from the relation of the amounts of accrued depreciation to the amounts of reproduction cost new of both accounts are applied to the amounts of original cost in both accounts, the resulting product of so-called depreciated original cost aggregates a sum equal to 13.5% of the original cost of the property in the accounts, whereas the weighted average of actually accrued depreciation, applying to the reproduction cost new, is only 12.3%.

	Reproduction Cost New[1]	Accrued Depreciation[1]	Percentage of Depreciation
Acct. 278	110,505	16,576	15.
Acct. 279	62,378	4,783	7.6
Total	173,083	21,359	12.3

	Original Cost[2]	Percentage of Depreciation	Accrued Depreciation
Acct. 278	93,724	15.	14,054
Acct. 279	24,121	7.6	1,833
Total	117,845	13.5	15,887

[1] As appears by Company Exhibit No. 8.
[2] As appears by Company Exhibit No. 9.

recognition by the Commission's engineers, as well as Appellee's, of the obvious fallacy of any such attempted depreciation. Whatever may be the reason, the fact remains that any finding as to the depreciation to be deducted from the original cost is **a finding without evidence.**

Finally, it should be said that not a single authority can be cited among the many opinions of this Court approving this attempt to depreciate original cost. The Commission's action in so doing is manifestly unlawful and constitutes a method of fixing rates which violates the procedural due process guaranteed by the federal constitution. *West v. Chesapeake & Potomac Tel. Co., supra.*

Going Concern Value.

The Appellee contended that, in a proper determination of the fair value of its property, it was entitled to an allowance for going concern value in the sum of not less than $400,000. Appellee's witness Seelye, in reviewing the factors considered in arriving at this judgment figure, testified he considered (1) the character of the territory served by the company, including the wide diversity of industries represented therein (2) the sound economic record of the territory served (3) the ability of the company to earn a reasonable return under low rates (4) the efficiency of the management of the company as indicated by the condition of its property and the high character of its service (5) an adequate available power supply and (6) the sound capital structure of the company, as indicated by its low capitalization and the absence of funded debt (R. 793-796). It is submitted that such factors are relevant and necessary to a proper determination of an al-

lowance for going concern value. *Bluefield Co. v. P. S. C., supra; Des Moines Gas Co. v. City of Des Moines, supra.*

To refute the above testimony the Commission offered **no evidence whatever** of going concern value other than a rather futile attempt to determine the so-called lag in the earnings of the Appellee in the early years of its existence.* For this purpose the Commission assumed that 6% was a fair rate of return as far back as 1886 and thereby attempted to show that when the Appellee's predecessors originally commenced business, there was no lag in earnings except in instances where their net annual return was less than 6% (Commission Exhibit No. 24, R. 235-265, 412-423). This, of course, is preposterous. No public utility could have existed in 1886 on a return as low as 6%, and even as late as 1933 the Pennsylvania Public Service Commission itself allowed a rate of return of 7%. However, the witness sponsoring this amazing contention admitted that even his treatment showed a lag in earnings, *the amount of which he did not and could not compute* (R. 418).

A conception of going concern value based entirely upon this so-called lag is completely at variance with the definition and elements thereof contained in a

* The Pennsylvania cases on the subject hold that lag in earnings is one of the elements making up going concern *value*. In *Borough of Hanover v. Hanover Sewer Company*, 251 Pa. 95, the Court stated that lag was to be considered in connection with other matters. And in *Ben Avon Borough v. Ohio Valley Water Co.*, 68 Pa. Superior Ct. 561 (1917), the Court stated at page 587:

> "The time and money expended in the promotion of the enterprise, the cost of securing and retaining customers, the loss of earnings on a reasonably well developed plant during its initial years, when its business is being built up, the increased value which comes from the consolidation of separate plants into one concern, these items, *with the value that inheres in a plant with its business established*, may be termed going concern cost of value."

long line of decisions of this Court. The gist of these decisions is admirably stated in the opinion in *Des Moines Gas Co. v. City of Des Moines, supra*, wherein this Court stated, at page 165:

> "That there is an element of value in an assembled and established plant, doing business and earning money, over one not thus advanced, is self-evident. This element of value is a property right, and should be considered in determining the value of the property, upon which the owner has a right to make a fair return when the same is privately owned, although dedicated to public use."

In the light of these decisions it cannot be contended that, by offering one fragmentary and wholly erroneous exhibit concerning a so-called lag in earnings, the Commission produced **substantial evidence** that there was no going concern value applicable to the temporary rate base of the Appellee or that the figure for going concern value was anything less than the eminently fair and reasonable estimate of the Appellee, namely, $400,000.

The Commission, although stating that it considered going concern value in arriving at its estimate of fair value in fact made no allowance for this item (R. 24-27, 28-29), as is apparent from the three following computations:

(i) The estimated original cost of Appellee's property devoted to the public service, as of September 30, 1937, was $5,111,851. For working capital the Commission properly found $164,000, so that the resultant total is $5,275,851, *with nothing included therein for going concern value.*

(ii) The estimated depreciated reproduction cost of Appellee's property as of June 30, 1937 was $5,-

350,000, to which should be added the Commission's allowance for working capital, producing a result of $5,514,000, *with nothing included therein for going concern value or net additions.*

(iii) The mean estimate (i. e. allowing equal weight to each of *reproduction and original cost*) to which should be added the Commission's allowance for working capital, produces a result of $5,394,925, *with nothing included therein for going concern value.*

It is respectfully submitted that there is no substantial evidence to justify such exclusion of going concern value in a determination of fair value and, further, that the Commission has arbitrarily and again repealed "unimpeached evidence submitted for the company" (*West Ohio Gas Co. v. P. U. C., supra*).

We submit that the Commission has (i) reached a conclusion as to fair value without substantial evidence to support the same, (ii) arbitrarily disregarded unimpeached evidence offered by Appellee, and (iii) adopted methods for determining the basis for the prescription of temporary rates which are repugnant to well established legal principles, all in violation of the requirements of due process of law.

Rate of Return.

It has been consistently held that the minimum of a fair return on value varies with the circumstances (*Dayton-Goose Creek Ry. v. Commission*, 263 U. S. 456 (1924), and hence must be determined after a consideration of the facts developed by the evidence in each particular case. There are, however, decisions of this Court setting forth some of the controlling principles by which regulatory bodies must determine a fair rate of return.

In *Bluefield Company v. Public Service Commission, supra,* at 692-693, it was said:

> "What annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts. A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprise or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility, and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties."

See also:

United Railways v. West, supra (1930).

Mr. Justice Brandeis in his concurring opinion in *Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission of Missouri, supra,* at pp. 290-291, said:

> "The investor agrees, by embarking capital in a utility, that its charges to the public shall be reasonable. • • • The compensation which the Constitution guarantees an opportunity to earn is the reasonable cost of conducting the business. Cost includes not only operating expenses, but also capital charges. Capital charges cover the allowance by way of interest, for the use of the capital, what-

ever the nature of the security issued therefor; the allowance for risk incurred; and enough more to attract capital. *The reasonable rate to be prescribed by a commission may allow an efficiently managed utility much more.*"

The Appellee introduced the testimony of Henry D. Boenning, an investment banker of Philadelphia, George H. Knutson, a public utility consultant with successful experience as an executive of operating public utilities, and Dr. Frank Parker, professor of political economy at the Wharton School of Finance of the University of Pennsylvania.

Mr. Boenning's testimony is contained on pages 1042 to 1068 of the Supreme Court Record. It is apparent therefrom that the witness has had an extended and successful experience in connection with the distribution and sale of securities of public utilities, particularly those engaged in business in the Commonwealth of Pennsylvania. The witness was interrogated as to the actual cost which would be experienced by Appellee in raising capital in the amount of $5,250,000 (fair value as found by Commission) or $5,500,000 (**minimum** fair value claimed by Appellee) to be expended for the purpose of reproducing the present property of Appellee devoted to the public service. The witness was further questioned as to the annual net revenue (*i. e.*, operating income) which, in his opinion, would be required to support a capitalization in either of the two last mentioned principal sums.

In reply to questions of the above character, Mr. Boenning testified that he was familiar with the earnings of the Appellee for the past three calendar years and with its balance sheet as of September 30, 1937. He further

stated that Appellee would require an annual operating income of $409,300 to support a capitalization of $5,250,000 which is equivalent to a return of 7.8% and an annual operating income of $432,650 to support a capitalization of $5,500,000 which is equivalent to a return of 7.88% (R. 1053).

It is clear from the record that the witness did not concern himself, in expressing these opinions, with a mere *academic* discussion of the return required by Appellee but, on the contrary, gave in detail the reasons which would require Appellee to earn the return he suggested in order to attract its required capital. Among the relevant factors which Mr. Boenning considered, in addition to his aforementioned knowledge of Appellee's property and affairs, were (a) the yields on shares of stocks and bonds of comparable public utilities as disclosed by current market quotations, (R. 1046, 1047); (b) recent offerings and sales of securities by various public utility companies, (R. 1049-1051); and (c) the costly effect upon Pennsylvania utilities in acquiring capital as a result of the policies and activities of the National Administration and of the Commission (R. 1056-1057).

Appellee's witness, Mr. Knutson, testified that, based on his long experience as a public utility executive and consultant to various financial institutions and utilities, Appellee would require "a minimum of 8%" under existing conditions (R. 1071). The factors considered by him in reaching this conclusion included (a) the history of Appellee; (b) its immediate capital requirements; (c) the value and condition of its property; (d) prevailing cost of money; (e) state of mind of the investing public with respect to securities of pub-

lic utilities as a result of the policies of the National Administration and the Commission; and (f) various considerations relating to the territory, business and affairs of the Appellee. In support of his position, the witness quoted from numerous recognized and reputable publications of statistical organizations containing comments, *inter alia*, on the disadvantages inuring to Pennsylvania utilities as a result of the activities and practices of the Commission, including such generally accepted and highly regarded organizations as "Standard Statistics" (R. 1071-1080). It is respectfully submitted that Mr. Knutson fairly and fully developed the practical problems confronting Appellee, under prevailing conditions, in raising the capital necessary to render its public service and that his testimony complemented and supported that of Mr. Boenning.

The testimony of Appellee's witness, Dr. Parker, related in part to the present trend of prices of commodities in the United States and demonstrated, without contradiction, that such trend has been upward since 1933 without any present indication of a recession therein. The witness further cited pending legislation and policies of the National Administration tending to produce inflationary results and higher prices (R. 1089-1105). In presenting this testimony of Dr. Parker, the Appellee gave heed to the principle enunciated and consistently adhered to by this Court, that rates are fixed for the future: *Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission of Missouri, supra; McCardle v. Indianapolis Water Co.*, 272 U. S. 407 (1926); *Love v. Atchison T. & S. Fe Ry. Co., supra; Municipal Gas Co. v. P. S. C.*, 225 N. Y. 89 (1918).

In the *McCardle* case (*supra*), the Court stated at page 408:

> "But in determining present value, consideration must be given to prices and wages prevailing at the time of the investigation; and, in the light of all the circumstances, there must be an honest and intelligent forecast as to probable price and wage levels during a reasonable period in the immediate future. In every confiscation case, the future as well as the present must be regarded. It must be determined whether the rates complained of are yielding and will yield, over and above the amounts required to pay taxes and proper operating charges, a sum sufficient to constitute just compensation for the use of the property employed to furnish the service; *that is a reasonable rate of return on the value of the property at the time of the investigation and for a reasonable time in the immediate future.* S. W. Tel. Co. v. Pub. Serv. Comm., 262 U. S. 276, 287, 288; Bluefield Co. v. Pub. Serv. Comm., 262 U. S. 679, 692. Cf. Board of Utility Commissioners v. New York Telephone Co., 271 U. S. 23, 31."

And in the *Missouri ex rel. Southwestern Bell Telephone Company* case (*supra*), the Court succinctly stated at pages 288-289:

> "It is impossible to ascertain what will amount to a fair return upon properties devoted to public service without giving consideration to the cost of labor, supplies, etc., at the time the investigation is made. An honest and intelligent forecast of probable future values made upon a view of all the relevant circumstances, is essential. If the highly important element of present costs is wholly disregarded, such a forecast becomes impossible. Estimates for tomorrow can not ignore prices of today."

Despite this uncontradicted testimony, the Commission restricted Appellee to a rate of return of 6% on its finding of the alleged fair value of Appellee's property (R. 30). The only evidence adduced by the Commission dealing with rate of return is that of the witness McShea, a member of its accounting staff, who contented himself with sponsoring an exhibit which dealt with yields on stocks of various corporations (industrials as well as utilities) not comparable to Appellee, and with rates at which corporate loans had been financed over a period of past years. It is inescapable that the Commission, in the instant case, has merely adopted the practice of its predecessors (the Pennsylvania Public Service Commission) in prescribing a rate of return **uniform for all utilities and without reference to the circumstances relating to the subject of the particular inquiry.** Such action is not only inimical to the doctrine declared in the above-quoted opinions of this Court, but is contrary to the admonition of the Pennsylvania Superior Court in *Pennsylvania Power & Light Co. v. Public Service Commission, et al.*, 128 Pa. Superior Ct. 195 (1937), wherein the Court stated at page 213:

> "The commission erred first in arbitrarily fixing the same rate for all utilities and, second, in fixing the rate without consideration of the risks and uncertainties involved. When the former commission based the allowable rate of return on a former resolution and ignored the facts in the case, it not only did not act in compliance with law but made a wide departure from a legal course. The rates at which *'corporate loans are being currently refinanced'* is not the criterion as clearly appears from the excerpts from the opinion of the Supreme Court of the United States. We do not need to look beyond the record to conclude that the

risks and hazards of the business of the respondent are much greater than those of a water company. *The rate allowable is a fact to be determined from the evidence like any other fact, and not by a standing resolution.*"

Thus there is found another illustration of a determination without substantial evidence or without facts in the record to justify impeaching relevant and substantial evidence adduced by Appellee. *West Ohio Gas Co. v. Ohio P. U. C., supra.*

It is submitted that the rate of return allowed the Appellee, in the opinion and order complained of, is contrary to all of the relevant evidence with respect to the proper rate of return to which Appellee is entitled.

Operating Expenses.

The Commission completely disallowed certain operating expenses actually incurred and paid by Appellee (R. 32).

(1) It has elected to disallow completely actual expenses incurred in connection with the very subject of this suit—rate case expense—despite the fact that (a) the proceedings were instituted on the Commission's own motion; (b) much of the data produced at the hearings was demanded of the Appellee by the Commission; (c) the Commission's previous temporary rate order was the subject of litigation costly to the Appellee and as a result of which the said order was enjoined; (d) no contention is made by the Commission that the amount of the rate case expense incurred is unreasonable or in any manner inflated; and (e) the Commission has assessed against and charged Appellee with the approximate sum of $5,000 representing rate case expense *incurred by the Commission* in connection with said proceedings.

Authority for the necessity of an allowance for reasonable rate case expense can be found in *Wabash Valley Electric Co. v. Young*, 287 U. S. 488 (1933); *West Ohio Gas Co. v. Public Utilities Commission, supra* (citing with approval *Denver Union Stockyard Co. v. U. S.*, 57 Fed. (2d) 735, 763-764, D.C. D. Colo. 1932); *New York and Richmond Gas Co. v. Prendergast*, 10 Fed. (2d) 167, 181, 182 (D.C. E.D. N.Y. 1925); and *Monroe Gas Light & Fuel Co. v. Michigan Public Utilities Commission*, 11 Fed. (2d) 319, 325 (D.C. E.D. Mich. 1926).

The sole excuse given by the Commission (R. 32) for disallowing such expenses is that Appellee has been earning excessive rates. This excuse, even if it were true, is fully answered in *Newton v. Consolidated Gas Co. of New York*, 258 U. S. 165 (1922), wherein it is said at page 175:

> "Since 1907 the Gas Company has been subject to supervision by a commission empowered to prohibit unreasonable rates, and the presumption is that any profits from its business were lawfully acquired."

and by the further opinion of this Court in *Board of Public Utility Commissioners v. N. Y. Telephone Company*, 271 U. C. 23, 32, (1926), where it said:

> "And the law does not require the company to give up for the benefit of future subscribers any part of its accumulations from past operations. *Profits of the past cannot be used to sustain confiscatory rates for the future.*"

Thus Appellee is faced with the astounding ruling of the Commission, that, in a determination of operating expenses necessary to be allowed in an ordered reduction of $435,000 per annum in Appellee's annual gross revenues, no allowance will be made it for $178,374.50

(R. 32, 35) of necessary and actual expenses admittedly incurred incident to the proper conduct of the rate proceedings.

(2) The Commission disallowed as an operating expense the sum of $20,593 which Appellee is required to expend annually as a part of salaries paid to its employees and officers (R. 34) although the existence of such expense is conceded, and **not a scintilla of evidence has been adduced by the Commission questioning either the propriety or amount of such payment.** It is difficult to conceive of a more arbitrary action by a regulatory body than this refusal to make any allowance for such an actual and undisputed annual operating expense.

(3) The Commission, in calculating Appellee's gross revenues for the purpose of computing its ordered reduction of $435,000, has refused to give any consideration to a loss in annual profit in the sum of $15,000. Annual revenue in this sum resulted in the past from the sale of energy by Appellee to York Railways Company (R. 1018), the railway service of which latter is to be forthwith abandoned *pursuant to an order of the Commission.* Clearly, therefore, such profit in the sum of $15,000 is completely wiped out and will not recur. This should have been recognized by the Commission in making its aforementioned computation, particularly since rates must be made for the future.

In view of the action of the Commission (i) in denying the Appellee any allowance for its rate case expense, (ii) in denying the Appellee any allowance for the aforementioned payments of salaries, and (iii) in refusing to exclude from Appellee's revenue the past revenues which would accrue in the future, Appellee respectfully submits that the order complained of is wholly lacking in any substantial support in the evidence, and constitutes a denial of procedural due process of law.

B.

THE ORDER OF THE COMMISSION CONFISCATES THE APPELLEE'S PROPERTY.

Summarizing what has been said herein, it is manifest that the Commission, in arriving at $5,250,000 as the fair value of Appellee's property for the prescription of temporary rates, erred in the following respects:

(1) By deducting from Appellee's estimate of reproduction cost the sum of $212,807, representing *general overheads*, where there was no competent testimony or evidence before the Commission justifying such deduction.

(2) By failing to give any consideration in its determination of *reproduction cost*, to the rise in prices of labor and materials between November 30, 1936 and June 1, 1937 in the sum of $447,698.*

(3) By failing to give any consideration in its determination of *reproduction cost* to the net additions to Appellee's plant and property between November 30, 1936 and September 30, 1937 at an actual cost of $142,851.97*

(4) By deducting from Appellee's estimate of *original cost* the sum of $349,800, representing the amount included therein for cost of financing.

(5) By deducting from Appellee's estimate of *original cost* the sum of $506,000, representing purported depreciation, despite the fact that there is *no* evidence in the record as to the manner in which original cost can be depreciated, nor is there any legal authority for such attempted depreciation. Furthermore, the method actually adopted by the Commission is **clearly fallacious**, even if it be assumed that original cost can be properly depreciated.

* No evidence offered in contradiction of this item.

(6) By failing to give any consideration in its determination of *original cost* to the net additions to Appellee's plant and property between November 30, 1936 and September 30, 1937 at an actual cost of $142,851.07.*

(7) By failing to make any allowance for going concern value in its determination of *fair value*.

Restoring the aforementioned improper deductions and omissions, and considering only the competent evidence before the Commission relating to the various elements of the fair value of Appellee's property as of the date nearest to the date of the challenged order, the following derivations of fair value result:

Giving Predominant Weight to Reproduction Cost:

Reproduction cost new less accrued depreciation, as of June 1, 1937	$5,350,000
Net additions between November 30, 1936 and September 30, 1937, at cost, not included in preceding item	142,581
Working capital as allowed by Commission	164,000
Going Concern Value	400,000
TOTAL	$6,056,581

Giving Predominant Weight to Original Cost:

Original cost as of November 30, 1936	$4,969,000
Net additions between November 30, 1936 and September 30, 1937 at cost, not included in preceding item	142,581
Working capital as allowed by Commission	164,000
Going Concern Value	400,000
TOTAL	$5,675,581

* No evidence offered in contradiction of this item.

It becomes apparent that the Commission's finding of $5,250,000 is clearly confiscatory. It is likewise apparent from uncontradicted testimony that the order of the Commission is being reviewed at a time when prices relating to wages and materials are rising; and hence it would follow that predominant weight *should be given* to depreciated reproduction cost in a determination of fair value. On this basis confiscation to the extent of approximately $800,000 of Appellee's property results from the adoption of the Commission's rate base. Even if original cost were adopted as the sole measure of fair value the resulting confiscation would be approximately $425,000. Assuming that equal weight or consideration should be given to depreciated reproduction cost and original cost, the result would be a finding of fair value in the sum of $5,866,081 or *approximately $616,000 in excess of the Commission's determination of the value of Appellee's property.*

In addition, however, to the above respects in which the order complained of is confiscatory, the following additional errors appear in said order:

(8) The refusal of the Commission to make any allowance to Appellee for its actually incurred rate case expense in the sum of $178,374.50.*

(9) The refusal of the Commission to make any allowance to Appellee for actual necessary payments to its officers and employees in the increased amount of $20,593 per annum.*

(10) The refusal of the Commission to make any allowance for actual loss in revenues in the annual sum of

* No evidence offered in contradiction of this item.

$15,000 to be suffered by Appellee as a result of the ordered abandonment of service by York Railways Company.*

(11) The refusal by the Commission to allow Appellee a rate of return of at least 7½%, in the light of the uncontradicted evidence that such a return is essentail in order for Appellee to attract required capital and properly render its public service.

The Commission contends, at p. 57 of its brief, that the return allowed by its order is 6% on a rate base of $6,408,330.16. But it neglects to state that the return excludes from operating expenses items which should have been included, fails to exclude non-recurring income, and that the rate applied (6%) is 2% lower than the necessary rate established by testimony of experts uncontradicted and unrefuted by any substantial evidence.

The confiscation resulting from these errors is obvious. Taking the most conservative estimate of $5,866,081 as the fair value of Appellee's property, and an equally conservative rate of return of 7½%, we find a properly allowable return of $439,956. This calculation takes the mean between the depreciated reproduction cost and the original cost of Appellee's property (despite the fact that due to rising price levels more weight should be given to the former) and also accepts the lowest rate of return testified to by any witness. Adding the foregoing return to the allowances made by the Commission for expenses, taxes and maintenance, we obtain an allowable gross revenue of $1,822,785. The order of the Commission, however, allows a gross of only $1,767,329.

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* No evidence offered in contradiction of this item.

This is clear confiscation even before a consideration of the Commission's erroneous disallowance of admitted expenses. Such a consideration (including rate case expense amortized over a period of five years) increases the annual confiscation by over $70,000. Indeed, even if we take original cost as the rate base, the amount of confiscation is reduced by only $14,288.

This conclusion becomes even clearer upon an examination of the only real evidence in the record concerning the actual return necessary to permit the Appellee to finance itself and to attract necessary capital. The sole detailed testimony on this point is that of Appellee's witness Boenning. This witness, manifestly a man of wide experience in the raising of capital and in the sale and distribution of public utility securities, and one who was familiar with the operations of the Appellee for the past three years as well as the value of its property and its earnings and expenses, testified that he could finance an aggregate capitalization of $5,500,000 for the Appellee only if the latter was guaranteed an annual operating income of $432,650 (R. 1053). Even this, it must be noted, would not provide the additional return necessary to create a surplus for unknown contingencies which this Court has uniformly allowed. (See concurring opinion of Mr. Justice Brandeis in *Missouri ex rel. Southwestern Bell Telephone Company vs. Public Service Commission of Missouri, supra.* Yet under the ordered rate reduction, the allowable return of the Appellee is reduced far below the minimum return which the record shows is necessary to support its capitalization alone.

Manifestly, the ordered rate reduction, in the totality of its consequences, is confiscatory and constitutes a clear

taking of Appellee's property without just compensation.

Because of all of the foregoing errors, Appellee respectfully submits that the enforcement of the order complained of will clearly result in a confiscation of its property in violation of the 14th Amendment to the Constitution of the United States and in violation of the Constitution of the Commonwealth of Pennsylvania.

CONCLUSION.

It is respectfully submitted that Appellee has clearly demonstrated that the order complained of was made in violation of the terms of the statute; that the statute under which the order was purportedly made is manifestly unconstitutional; that the order was made without substantial evidence to support it and in disregard of uncontradicted evidence of probative value; and that the rates it imposes are confiscatory. The findings and conclusions of the District Court are amply sustained by the evidence, the facts, and the law, and its decree should be affirmed.

Respectfully submitted,

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APPENDIX A.

SECTIONS OF THE PUBLIC UTILITY LAW RELEVANT TO THE ISSUES INVOLVED IN THIS CASE.

Section 304. Discrimination in Rates.—No public utility shall, as to rates, make or grant any unreasonable preference or advantage to any person, corporation, or municipal corporation, or subject any person, corporation, or municipal corporation to any unreasonable prejudice or disadvantage. No public utility shall establish or maintain any unreasonable difference as to rates, either as between localities or as between classes of service. Unless specially authorized by the commission, no public utility shall make, demand, or receive any greater rate in the aggregate for the transportation of passengers or property of the same class, or for the transmission of any message or conversation for a shorter than for a longer distance over the same line or route in the same direction, the shorter being included within the longer distance, or any greater rate as a through rate than the aggregate of the intermediate rates. Nothing herein contained shall be deemed to prohibit the establishment of reasonable zone or group systems, or classifications of rates or, in the case of common carriers, the issuance of excursion, commutation, or other special tickets at special rates, or the granting of nontransferable free passes, or passes at a discount to any officer, employe, or pensioner of such common carrier. No rate charged by a municipality for any public utility service rendered or furnished beyond its corporate limits shall be considered unjustly discriminatory solely by reason of the fact that a different rate is charged for a similar service within its corporate limits.

* * * * * * * *

Section 307. Sliding Scale of Rates.—(a) Any public utility, except a common carrier, may establish a sliding scale of rates or such other method for the automatic adjustment of the rates of the public utility as shall provide

a just and reasonable return on the fair value of the property used and useful in the public service, to be determined upon such equitable or reasonable basis as shall provide such fair return: Provided, That a tariff showing the scale of rates under such arrangement is first filed with the commission, and such tariff, and each rate set out therein, approved by it. The commission may revoke its approval at any time and fix other rates for any such public utility if, after notice and hearing, the commission finds the existing rates unjust or unreasonable.

(b) The commission, by regulation or order, upon reasonable notice and after hearing, may prescribe for any class of public utilities, except a common carrier, a mandatory system for the automatic adjustment of their rates, by means of a sliding scale of rates or other method, on the same basis as provided in paragraph (a), to become effective when and in the manner prescribed in such regulation or order. Every such public utility shall, within such time as shall be prescribed by the commission, file tariffs showing the rates established in accordance with such regulation or order.

* * * * * * * *

Section 310. Temporary Rates.—(a) The commission may, in any proceeding involving the rates of a public utility brought either upon its own motion or upon complaint, after reasonable notice and hearing, if it be of opinion that the public interest so requires, immediately fix, determine, and prescribe temporary rates to be charged by such public utility, pending the final determination of such rate proceeding. Such temporary rates, so fixed, determined, and prescribed, shall be sufficient to provide a return of not less than five per centum upon the original cost, less accrued depreciation, of the physical property (when first devoted to public use) of such public utility, used and useful in the public service, and if the duly verified reports of such public utility to the commission do not show such original cost less accrued depreciation, of such property, the commission may estimate such cost less

depreciation and fix, determine, and prescribe rates as hereinbefore provided.

(b) If any public utility does not have continuing property records kept in the manner prescribed by the commission, under the provisions of section five hundred two of this act, then the commission, after reasonable notice and hearing, may establish temporary rates which shall be sufficient to provide a return of not less than an amount equal to the operating income for the year ending December thirty-first, one thousand nine hundred thirty-five, or such other subsequent year as the commission may deem proper, to be determined on the basis of data appearing in the annual report of such public utility to the commission for the year one thousand nine hundred thirty-five, or such other subsequent year as the commission may deem proper, plus or minus such return as the commission may prescribe from time to time upon such net changes of the physical property as are reported to and approved for rate-making purposes by the commission. In determining the net changes of the physical property, the commission may, in its discretion, deduct from gross additions to such physical property the amount charged to operating expenses for depreciation or, in lieu thereof, it may determine such net changes by deducting retirements from the gross additions: Provided, That the commission, in determining the basis for temporary rates, may make such adjustments in the annual report data as may, in the judgment of the commission, be necessary and proper.

(c) The commission may, in the manner hereinbefore set forth, fix, determine, and prescribe temporary rates every month, or at any other interval, if it be of opinion that the public interest so requires, and the existence of proceedings begun for the purpose of establishing final rates shall not prevent the commission from changing every month, or at any other interval, such temporary rates as it has previously fixed, determined, and prescribed.

(d) Whenever the commission, upon examination of any annual or other report, or of any papers, records, books, or documents, or of the property of any public utility, shall be of opinion that any rates of such public utility are producing a return in excess of a fair return upon the fair value of the property of such public utility, used and useful in its public service, the commission may, by order, prescribe for a trial period of at least six months, which trial period may be extended for one additional period of six months, such temporary rates to be observed by such public utility as, in the opinion of the commission, will produce a fair return upon such fair value, and the rates so prescribed shall become effective upon the date specified in the order of the commission. Such rates, so prescribed, shall become permanent at the end of such trial period, or extension thereof, unless at any time during such trial period, or extension thereof, the public utility involved shall complain to the commission that the rates so prescribed are unjust or unreasonable. Upon such complaint, the commission, after hearing, shall determine the issues involved, and pending final determination the rates so prescribed shall remain in effect.

(e) Temporary rates so fixed, determined, and prescribed under this section shall be effective until the final determination of the rate proceeding, unless terminated sooner by the commission. In every proceeding in which temporary rates are fixed, determined, and prescribed under this section, the commission shall consider the effect of such rates in fixing, determining, and prescribing rates to be thereafter demanded or received by such public utility on final determination of the rate proceeding. If, upon final disposition of the issues involved in such proceeding, the rates as finally determined, are in excess of the rates prescribed in such temporary order, then such public utility shall be permitted to amortize and recover, by means of a temporary increase over and above the rates finally determined, such sum as shall represent the difference between the gross income obtained from the

rates prescribed in such temporary order and the gross income which would have been obtained under the rates finally determined if applied during the period such temporary order was in effect.

* * * * * * * *

Section 313. Refunds.—(a) If, in any proceeding involving rates, the commission shall determine that any rate received by a public utility was unjust or unreasonable, or was in violation of any regulation or order of the commission, or was in excess of the applicable rate contained in an existing and effective tariff of such public utility, the commission shall have the power and authority to make an order requiring the public utility to refund the amount of any excess paid by any patron, in consequence of such unlawful collection, within two years prior to the date of the filing of the complaint, together with interest at the legal rate from the date of each such excessive payment. In making a determination under this section, the commission need not find that the rate complained of was extortionate or oppressive. Any order of the commission awarding a refund shall be made for and on behalf of all patrons subject to the same rate of the public utility. The commission shall state in any refund order the exact amount to be paid, the reasonable time within which payment shall be made, and shall make findings upon pertinent questions of fact. An appeal may be taken to the Superior Court from any refund order, but if no such appeal is taken, the parties shall be bound by the findings and orders of the commission.

(b) If the public utility fails to make refunds within the time for payment fixed by any final order of the commission, or any appellate court, as the case may be, any patron entitled to any refund may sue therefor in any court of common pleas of this Commonwealth, and the findings and order made by the commission shall be prima facie evidence of the facts therein stated, and that the amount awarded is justly due the plaintiff in such suit, and the defendant public utility shall not be per-

mitted to avail itself of the defense that the service was, in fact, rendered to the plaintiff at the rate contained in its tariffs in force at the time payment was made and received, nor shall the defendant public utility be permitted to avail itself of the defense that the rate was reasonable: Provided, That any patron entitled to any refund shall be entitled to recover, in addition to the amount of refund, a penalty of fifty per centum of the amount of such refund, together with all court costs and reasonable attorney fees. No suit may be maintained for a refund unless instituted within one year from the date of the order of the commission or its final affirmance by an appellate court. Any number of patrons entitled to such refund may join as plaintiffs and recover their several claims in a single action, in which action the court shall render a judgment severally for each plaintiff as his interest may appear.

(c) No action shall be brought in any court for a refund, unless and until the commission shall have determined that the rate in question was unjust or unreasonable, or in violation of any regulation or order of the commission, or in excess of the applicable rate contained in an existing and effective tariff, and then only to recover such refunds as may have been awarded and directed to be paid by the commission in such order.

* * * * * * * *

Section 502. Continuing Property Records.—The commission may require any public utility to establish, provide, and maintain as a part of its system of accounts, continuing property records, including a list or inventory of all the units of tangible property used or useful in the public service, showing the current location of such property units by definite reference to the specific land parcels upon which such units are located or stored; and the commission may require any public utility to keep accounts and records in such manner as to show, currently, the original cost of such property when first devoted to the

public service, and the reserve accumulated to provide for the depreciation thereof.

. . . . . .

Section 1103. Supersedeas; Security.—No appeal from any order of the commission, except as hereinafter provided, shall, in any case, operate as a supersedeas of the order appealed from unless the Superior Court shall, by an interlocutory order, make such appeal a supersedeas. Such interlocutory order shall be made only after such notice to the commission and other parties of record as the court may direct, and after hearing. Upon the granting of a supersedeas in any case, the court may, in its discretion, require the filing of a bond to the Commonwealth for the use of all parties aggrieved, in such sum and conditioned as the court may, by its order, direct, or may grant the supersedeas upon such other terms and conditions as the court, in its discretion, may prescribe: Provided, That the effect of any such supersedeas shall be to continue in effect the temporary rates, if any, previously established in the proceeding by the commission.

APPENDIX B.

THE COMMISSION'S EFFORT TO PERSUADE THIS COURT TO REVERSE THE DOCTRINE PRONOUNCED BY IT IN SMYTH V. AMES.

The Commission urges this Court to repudiate the principles enunciated by it in *Smyth v. Ames*, supra, defining what has been for more than forty years the basis for the determination of fair value in the prescription of rates of public utilities. Those principles, often repeated in a long line of subsequent decisions, are so well known to this Court that it is idle to restate them here.

Willcox v. Consolidated Gas Co., 212 U. S. 19;
Minnesota Rate Cases, 230 U. S. 352;
Missouri ex rel. Southwestern Bell Teleph. Co. v. Public Serv. Commission, 262 U. S. 276;
Bluefield Waterworks & Improve. Co. v. Public Serv. Commission, 262 U. S. 679;
McCardle v. Indianapolis Water Co., 272 U. S. 400;
St. Louis & O'Fallon R. Co. v. United States, 279 U. S. 461;
Los Angeles Gas and Electric Corp. v. Railroad Commission of the State of Calif., 289 U. S. 287;
West, et al., v. C. & P. Telephone Co., 295 U. S. 662;
Railroad Commission v. Pacific Gas & Electric Co., 302 U. S. 388.

In lieu of the fair value rule announced in those decisions, the Commission would have the reasonableness of rates determined solely by the allowance of a return on the "prudent original cost" of the property of the utility company involved.

A.

Before replying to the substance of the arguments advanced in support of this proposal, Appellee respectfully submits that the Commission's contention cannot properly be raised at this time for the reasons that:

1. The question was not raised in the court below, the Commission asserting there and in its brief (p. 58) filed in this Court that, in prescribing the temporary rates to be charged by the Appellee, the Commission *adhered* to the doctrine of *Smyth v. Ames*.

2. The plain provisions of the Pennsylvania Public Utility Law recognizes the *fair value* rule (i. e. the doctrine of *Smyth v. Ames*) as the basis for the prescription of rates and the Commission is hence bound thereby.

1. In the answer filed by the Commission to the bill of complaint and during argument in the court below, it was never contended by the Commission, as it now urges, that the doctrine of *Smyth v. Ames* should be repudiated and consideration given only to original cost in determining the rate base of the Appellee. On the contrary, the Commission there argued that consideration must be given to the various elements of fair value, including reproduction cost as well as original cost, as is manifest from the following quotation from p. 10 of the brief filed by the Commission with the court below:

> "The Supreme Court of the United States, in cases so numerous as to render citation thereof unnecessary, has established the principle that rates are nonconfiscatory which provide a fair return upon the fair value of utility property used and useful in the public service. Respondents earnestly contend that *Section*

310(a) of the Public Utility Law in nowise purports to allow or require the imposition of temporary rates in a manner inconsistent with the Supreme Court's interpretation of non-confiscatory regulation."

In the same brief at pp. 31-37 will be found a discussion of the extent to which it was claimed the Commission considered the various elements of fair value. At p. 19 thereof, in construing the effect of subparagraph (e) of Section 310, the Commission said:

> "Complainant has, at various times, raised the argument that Section 310(e) does not make an unconstitutional order constitutional. Nobody has ever claimed that it did. It was never intended to do so. Its clear intent is to assure full recoupment for any loss suffered by virtue of *a final constitutional rate being higher than a temporary constitutional rate.*"

From the foregoing it is inescapable that the position now taken by the Commission with respect to the rule of fair value is in direct contradiction of that which it urged upon the court below. Furthermore, a cursory examination of the record herein, including the Commission's opinion, discloses that the Commission did not limit its consideration to original cost in determining the rate base for the prescription of temporary rates. It is, therefore, apparent that in now urging the repudiation of the doctrine of fair value rule pronounced in *Smyth v. Ames*, the Commission raises merely an academic question, and one which has no proper place in a determination of the real issues involved in this case. It is a manifest effort here to inject a question which was not involved in the proceedings before the Commission, never discussed in its opinion and order, or even suggested by it during the trial or argument of the case before the court below.

It has been held that this Court, on appeal, will adhere to the theory of the case pursued in the trial court, and will not, as a rule, consider objections resting on a different theory than that upon which the appellant tried its case below.

Denver Union Stockyard Co. v. U. S., 304 U. S. 470 (1938).
Ohio v. Swift & Co., 260 U. S. 146 (1922).
Virginian Ry. Co. v. Mullens, 271 U. S. 220 (1926).

The Appellee, therefore, earnestly urges that the question raised is not properly before this Court.

2. Bearing in mind that the order here complained of was *purportedly* entered pursuant to statutory authority, it follows that the Commission is bound by all of the relevant provisions of that statute, and cannot properly be heard to argue against compliance with any of its valid provisions. The Appellee submits that the statute in question, as evidenced by reference to certain of its sections, clearly binds the Commission to compliance with the fair value rule in the prescription of (i) just and reasonable rates and (ii) permanent rates.

Section 307* authorizes any public utility other than a common carrier to "establish a sliding scale of rates, or such other method for the automatic adjustment of the rates of the public utility as shall provide *a just and reasonable return on the fair value of the property used and useful in the public service*, to be determined upon such equitable or reasonable basis as shall provide such fair return."

Subparagraph (d) of Section 310 purportedly empowers the Commission to prescribe trial rates for designated periods provided "such temporary rates to be observed

* Printed in full in Appendix A hereof.

by such public utility * * * will produce *a fair return upon such fair value* * * *."

These references to the Pennsylvania statute establish a clear and defined legislative intention to impose upon the Commission the duty of recognizing the rule of fair value in the prescription of rates on a sliding scale or trial rates.

Section 311,* entitled "Valuation of Property of a Public Utility", is the sole grant of statutory authority to value the property of a utility. This *requires* valuation on the basis of **fair value**. It is specifically provided that the Commission shall

> "* * * ascertain and fix the *fair value* of the whole or any part of the property of any public utility, in so far as the same is material to the exercise of the jurisdiction of the commission, and may make revaluations from time to time and ascertain the *fair value* of all new construction, extensions and additions to the property of any public utility."

The Appellee submits, therefore, that the Pennsylvania Public Utility Law itself makes manifest a legislative recognition of the doctrine of fair value as defined by the law of the land at the time of the passage of the statute.**

The Commission has only like powers granted by the Public Utility Law. If the legislature had intended to prescribe "prudent original costs" as the sole measure for the determination of a rate base, it is reasonable to assume that the statute would so provide. The fact is that *there is no such provision*, and that except for temporary rates, the fair value basis is the *only* one having legislative sanction. The Commission, therefore, is not

* Printed in full in Appendix A hereof.
** Enacted May 28, 1937, effective June 1, 1937.

merely attempting to interject a new question, but it is asking this Court to declare a principle contrary to the Commission's charter of authority. It is, in effect, not only asking the Court to determine a moot question but is also attacking the very statute committed to it for administration.

B.

Without reference to the propriety of the effort by the Commission to raise a new issue on appeal and to argue a proposition which is clearly repugnant to the statute pursuant to which the Commission is required to act, we submit that the Commission's contention is fundamentally unsound.

At the outset it is important to consider the nature and effect of this contention. The entire constitutional theory of rates has its fundamental basis in the principle that due process of law requires the payment of just compensation for the taking of property for a public use. In the case of a utility the taking of its property does not occur just once, when the property is originally constructed. On the contrary there is a constant taking of property every day by public regulation which prescribes the rates to be charged and controls the business and activities of the utility. Just compensation for any particular taking, then, must be determined as of the time of the particular taking involved —and to accomplish this *present* **value**, or *fair* **value**, must necessarily be considered the primary test.

The concepts of "cost", and "value", are entirely dissimilar. Cost and value are never synonymous, except accidentally.

It has never been argued that reproduction cost is the sole element of present value. Indeed, in cases involving taxation, condemnation, and other takings of property, fair value is determined by reference to market value, capitalization of earning power etc. In the case of a public utility, however, these methods cannot be applied. Being a monopoly a utility property seldom has a market value. Likewise, since the very purpose of the inquiry is to determine allowable earning power, that method cannot be used to determine value. Thus the reproduction or present cost estimate is in most cases the best, and in many cases the only, evidence of present value. But it is only a means to an end—not the end itself. The end has always been fair value.

In the light of these considerations, it becomes evident that the real effect of the Commission's position is to discard completely the whole concept of fair value. To read hastily the Commission's argument, it would seem that it merely asks this Court to change the rules of evidence. But when it is remembered that by rejecting present cost of construction we reject the *only* real evidence of *present cost*, (one of the essential elements in a proper determination of present *value*) it becomes obvious that the Commission is really asking this Court to declare that a utility is not entitled to a fair return on the fair value of its property—that the Constitution does not guarantee just compensation for the taking of property—but only a return on *past cost*.

With this understanding of the Commission's real contention, it is vital to the maintenance of constitu-

tional principles that this Court scrutinize with great care the practical aspects of the problem, to see if they justify such a reversal of the entire concept of due process of law as applied to the taking of property.

There is a fundamental reason that requires the consideration of present cost, as well as original cost, in a proper determination of fair value.

Original cost is an expression of the amount of dollars invested in a given property at the time of its original construction. Reproduction cost is but a translation of those dollars into a sum representing the cost of such property under prices prevailing at the time of the inquiry. That is to say, original cost is a summation of the dollars spent from day to day for the cost of the original installation or construction of the property when first devoted to the public use, and reproduction cost represents the sum by which those dollars have increased or decreased to reflect price levels prevailing as of the date of the determination of such reproduction cost. To fix rates solely on the basis of original cost is to completely ignore the difference between the purchasing power, in both materials and labor, of the dollars originally invested, and their value as of the date of the prescription of rates in a given proceeding.

The Commission's theory here advanced finds no support in the concurring opinion of Mr. Justice Brandeis in *Southwestern Bell Tel. Co. v. Public Service Commission of Missouri, supra.* The substance of that opinion is that a utility is entitled to earn a reasonable return on the "capital prudently invested in the enterprise." Such investment is far different than the Commission's hybrid "prudent original cost", for it embraces not only

sums expended in the actual *construction* of property when first devoted to public service, but also such sums as are prudently invested in the *acquisition* of properties constituting a part of the enterprise at the time of the particular rate inquiry. Such costs of acquisition inevitably reflect the value of the properties acquired as of the date of acquisition. Other capital "prudently invested in the enterprise" may likewise have been expended in costs incident to consolidations.

Many advocates of the prudent investment rule also support the principle that dollars, prudently spent in the enterprise, shall be translated into equivalent dollars of today, in order that justice shall thereby be done to the investor. Obviously, no such equitable consideration is contemplated or possible under a rule of law that would destroy the principle of *value* as a basis for the prescription of rates and substitute in lieu thereof, mere *cost*. Without elaborating further upon the difference between the school of thought that advocates prudent investment and that which urges a consideration of only original cost (i. e. cost of property when first devoted to the public service) as the basis for rate-making, it is submitted that the two are quite different in both their economic and legal approach.

It is also clear from the record that the "prudent investment" doctrine is a moot question in the instant case since it contains no evidence whatever of "prudent investment"—or of the total investment of *Appellee* in its property. Therefore, neither the validity of Section 310( )—which refers only to original cost of physical property when first devoted to public use—nor the adequacy of the rates prescribed by the Commission's order, can here be tested by the "prudent investment" standard.

It is urged by the Commission that an estimate of reproduction cost necessitates conjectural calculations. The frailties in this regard, if such they are, which the Commission ascribes to an estimate of reproduction cost, may be likewise ascribed to estimates of original cost. As a matter of fact, there is less conjecture in the preparation of a reproduction cost estimate than there is in the determination of the actual original cost of property installed over a period of many years.

Reference to the record (R. pp. 492-493) makes manifest that the estimate of reproduction cost in the instant case was divided into two parts. The first dealt with the direct cost "which would be experienced by a contractor in carrying out the work" and the second dealt with "the overhead costs which are specifically what might be incurred by the owners of the property" and that such division of the estimate "is clearly indicated by the uniform classification of accounts (i. e. the uniform Accounting System prescribed by the Commission) and is based on every day experience." The evidence shows that the unit prices of materials were determined by obtaining prices from manufacturers and dealers, with full benefit given for discounts resulting from quantity purchase, and that labor costs were based upon the prevailing wage scale in the City of York, Pennsylvania and environs as of the date of the estimate. (R. 492-493, 504-512, 517-527, 544-548).

A study of such character is no more conjectural than any other engineering estimate involving the exercise of human judgment in the light of a known sets of facts. Clearly it is *less conjectural* than an effort to determine the original cost of a utility plant and system constructed

over a period of years at varying price levels. It is manifestly no more difficult to obtain and apply prevailing unit prices to a *known* and *existing* quantity of materials than it is, as required in an estimate of original cost, to determine prices prevailing as of a prior date and over a considerable period of time during which the units of property of a utility were originally installed or constructed.

The fact is, there is nothing theoretical involved in determining the reproduction cost of a utility plant or system. The amount of quantities involved can, as was done in this case, readily be ascertained by a competent engineer, and the prices of such materials are likewise available to be applied to such quantities, thereby determining the reproduction cost of the same. The amount of labor required in the particular task of reconstruction is one which can be properly estimated by an experienced contractor or engineer and, when the prevailing wage scale in the community involved is adopted, the result is a reasonably accurate estimate of what such labor would cost in that community and under conditions existing in the local labor market.

One is confronted with the same problems in estimating the *original cost* of installing a given unit of property. There too the quantities must be estimated from plans and specifications and the labor costs must be obtained on the basis of the prevailing wage scale so that, in the final analysis, the magnitude of the task involved in preparing an estimate of reproduction cost is neither less nor unlike that involved in the preparation of an estimate of original cost. How then can it logically be argued that the former is more "conjectural", "hypothetical" or "unsound" than the latter?

It may be conceded that where the books of a particular utility company have at all times recorded the original cost of the installation or construction of property and such utility has maintained continuing property records disclosing additions and retirements at cost, the actual cost can then be determined with definite assurance. In the case at bar it is a fact that the books of the Appellee do not record the original cost of its plant and property (R. 402-412, 733-734) and this is true in the vast majority of cases. Even where original cost can be definitely determined from the books of a company or otherwise, to ignore all other elements of fair value is to ignore certain essential considerations in the proper determination of a rate base.

The Commission's brief, in assailing the propriety of accepting evidence of reproduction cost, criticizes allowances for general overhead expenses which are necessarily embraced within any competent estimate of reproduction cost. Such a criticism completely overlooks the perfectly obvious fact that the construction of a public utility or industrial plant necessarily requires the expenditure of money for something other than labor and materials. Such costs have been specifically recognized by this Court in *Des Moines Gas Co. v. City of Des Moines, supra,* and *are recognized by the Commission in its uniform classification of accounts prescribed for electric corporations.*

Included in the allowances for overhead expenses are such items as architect's fees, legal expenses, interest during construction, insurance and similar items of unavoidable expenses *necessarily incident to the original cost of the property, and hence to an intelligent estimate*

seeking to determine what would be its present cost. In this connection, the Court's attention is respectfully invited to Appendix III at page 1562 of the aforementioned Report of the Special Committee of the American Society of Civil Engineers, to which reference is made by the Commission at page 44 of its brief, in support of its argument that the reproduction cost doctrine is unsound from an engineering standpoint. A tabulation is there contained of actual overheads incurred in connection with the construction of given public works projects and the average expenditure for items embraced within general overheads (excluding taxes, interest during construction and discount on securities) *exceeds those used in the reproduction cost estimate of the company in the instant case.* Thus, the very report so much admired by the Commission recognizes not only the necessity of allowances for general overhead expenses, but discloses that the actual percentage of overheads in relation to the direct cost experienced on the average project mentioned in the report, were in excess of those here challenged by the Commission.

Indeed it is difficult to find where the Commission derives *any* comfort from the aforementioned report to support its contention that the element of reproduction cost should be ignored in determining a rate base or, expressed conversely, that original cost should be the sole measure of determining such rate base. At page 1356 of the report, the Committee observes that

> "• • • to ascertain original cost to date, it is necessary, as a rule, that a schedule be made of the various existing property items *in the same way that one would be made for determining the cost of reproduction*".

This is exactly the procedure followed in the preparation of the original cost estimate submitted by the company in the instant case and is strong support for the Appellee's contention that the magnitude of the task involved in an estimate of reproduction cost is no greater than the one involved in the preparation of an estimate of original cost.

The Commission, in its brief beginning at page 48, further contends that the reproduction cost rule is unsound from an accounting standpoint. Its *sole* argument in support thereof is that "There is no set of accounts which a regulatory commission can require a utility to keep in order to disclose the various elements of value now required by judicial mandate of *Smyth v. Ames* to be considered in the determination of the rate base". With the last-quoted observation, there will be no disagreement because, as this Court has repeatedly held, the determination of value is not a matter of formula. *Minnesota Rate Cases, supra.* It may be admitted that effective regulation demands that a utility should be required to record the original cost of its property and maintain continuing property records whereby all additions to and retirements from capital accounts are recorded at cost. Even after a strict compliance with such regulations, however, reference to a utility's books so maintained would not disclose the fair value of the company's property but merely its original cost—*one* of the elements of fair value. Fair value, it is submitted, is not an accounting problem, but involves a judicial determination to be made after a full and fair hearing in which all substantial evidence relating to the various elements of value is considered and properly weighed.

In connection with the Commission's criticism of the present rule of fair value from the accounting viewpoint,

Appellee cannot refrain from directing attention to the misleading nature of the reference on page 52 of the Commission's brief. It is a reference to the testimony of the president of American Water Works & Electric Co., Inc., before the Securities & Exchange Commission at a hearing held on September 15, 1937, in which the Pennsylvania Public Utility Commission intervened. The testimony mentioned, as is well known to the Commission, had no relation whatever to the fair value of the operating subsidiaries of the company there involved or to any estimates of reproduction or original cost. The write-up which occurred in the instance mentioned in the testimony, had to do with the write-up of capital stock resulting from a fluctuation in prices on the New York Stock Exchange. Any criticism of the practice referred to in that case has no relevancy to a discussion of the respective merits of reproduction and original cost as elements of fair value.

We submit that the foregoing discussion abundantly shows that the so-called "prudent original cost" doctrine which the Commission requests this Court to adopt as the constitutional standard of rate making is not the practical solution to the problem with which the Commission is faced, and that its adoption will in no way aid the Commission in the determination and prescription of rates. On the contrary, the determination of original cost involves the same elements of conjecture and estimate that are involved in a reproduction cost appraisal. In addition, the Commission's theory would add a further and even more conjectural element by the use of the word "prudent." This alone would involve the courts in endless litigation to determine in every specific case what part of the cost was prudently incurred. The test itself is wholly meaningless, and when

it is considered that the cost of most utility properties goes back over a long period of years, it is obvious that a determination of prudent cost can be made only in terms of an individual's opinion which can seldom, if ever, be fully supported by the facts, since all of the facts will not and cannot be known.

In the light of these considerations, it is particularly pertinent to inquire into the results which may reasonably be expected to follow the adoption of any such doctrine. The fair value rule of rate making has been followed uniformly by this Court for the last forty years. Obviously investors in utility enterprises have assumed that this constitutional protection would be afforded them. The entire utility industry in this country has been built up and capitalized on the theory that every utility was entitled to earn a **fair return upon the fair value of its property.** As a consequence, and this is common knowledge, utility securities are even in these depressed times selling on the security markets at prices relatively commensurate with what is believed to be the present value of those securities measured by the fair value of the properties which underly them, and on what is confidently assumed to be the fair return which the investor may expect upon such value. The adoption of the Commission's "practical" theory would result only in endless confusion and the destruction of all present values of public utility properties and securities.

Moreover, the substitution of *cost* for *value* as a rate base would have the necessary effect of eliminating the possibility of capital appreciation of investment in utility enterprises, since it would limit the return to a return on cost and would thus prevent any effective increase in value. Thus every utility investment, even

the common stock or equity investment, would be reduced to the status of a fixed interest obligation, and the profit motive, which must be recognized as valid so long as a capitalistic system is ours, would be removed from the utility enterprise.

The removal of the profit motive may be a sound theory as applied to a static condition. But it can hardly be questioned that the utility industry in this Country could never have been built up without that motive, which in turn is based upon the opportunity for capital appreciation of investment. We believe that to adopt a theory which will prevent the logical and necessary expansion of the utility industry through the continuous hope not only of steady return but also of capital appreciation is economically unsound, and that its practical effect would be disastrous.

In view of the attempt of the Commission in this case to introduce an entirely new conception of due process of law into the law of the land, it is important to revert once more to fundamentals and to inquire what just compensation for the taking of property is guaranteed under the Fourteenth Amendment of the Federal Constitution.

That the regulation by a state of the rates of a public utility is a "taking" of the utility's property within the Fourteenth Amendment of the Constitution of the United States and is hence within Section 1 of that Amendment, prohibiting the deprivation of property without due process of law, is too well settled to need citation of authorities. The complete analogy between rate regulation and condemnation is admirably stated in *West v. Chesapeake & Potomac Telephone Company*, 295 U. S. 662, 671, (1935) citing numerous cases:

"The established principle is that as the due process clauses (Amendments Five and Fourteen) safeguard private property against a taking for public use without just compensation, neither Nation nor State may require the use of privately owned property without just compensation. When the property itself is taken by the exertion of the power of eminent domain, just compensation is its value at the time of the taking. So, where by legislation prescribing rates or charges the use of the property is taken, just compensation assured by these constitutional provisions is a reasonable rate of return upon that value."

To the framers of the Constitution and to the courts of this country, compensation for the taking or the use of private property meant only one thing: a just payment for the *present value* of the private property so taken or so used. *Brett v. United States*, 86 Fed. (2nd) 305, 307, cert. denied, 301 U. S. 682, (1936); *United States v. Chandler-Dunbar Water Power Company*, 299 U. S. 51, 76 (1936); *United States v. Rogers*, 255 U. S. 162, 169 (1921); *Morton Butler Timber Company v. United States*, 91 Fed. (2nd) 884, 891 (1937). And while the fair market value of the property was the most desirable way of determining its present value, where it was impossible to obtain the market value of a property, the question was then one of ascertaining in some other way *the present value*. Undoubtedly, in such cases a legitimate source of information was the *cost* of the property, but always the end sought was the property's present value. Where reproduction cost (more properly called present cost) was obtainable, it was inevitably and uniformly considered.

In *Oshkosh Water Works Company v. Railroad Commission*, 161 Wis. 122 (1915), the Supreme Court of Wisconsin stated:

> "In the proper valuation of a public utility for condemnation or sale purposes certain named elements usually present in every case may legitimately be considered. These are the present values of its physical property, the present and prospective reasonable earnings of its business, the going value thereof, and the amount of money presently needed to put the plant in good condition. There may be other elements, but these are generally the essential ones. In determining the value of the physical property, due regard should be had to the original cost thereof, the reproduction cost, the amount of depreciation, and the amount of obsolescence."

Likewise, in the case of *In re United States Commission*, 295 Fed. 950 (1924), in construing a condemnation statute providing for the payment of "a sum of money equal to a fair and just valuation of the buildings and improvements then standing on said grounds," the Court of Appeals for the District of Columbia said:

> "We are of the opinion that the only just and legal method of arriving at the fair value of the property to be taken over by the government, under the provisions of the act, is to determine first the cost of reproduction based upon present values and deducting therefrom the amount of depreciation. This places a correct valuation upon what the authorities term the bare bones of the plant or its physical properties; in other words, *what it would cost to reproduce this building, not one that would take its place.*"

The Commission's theory, it is repeated, is not merely an attempt to change the rules of evidence that govern a determination of fair value in considering the com-

pensation due under the Constitution, nor is it a redefinition of what has been defined for time immemorial to be the fair value of such private property. It is rather a request to this Court to utterly abandon its conception of fair value and to adopt in lieu thereof something else. And this new conception declares that it is immaterial whether compensation be made for the fair value of property which is taken or used but that all that is necessary to be done is that compensation be made for the original cost of such property. If a man's house, then, is condemned by a state in the exercise of its powers of eminent domain, he shall not be entitled to a just compensation for its fair value but he shall be restricted to its original cost. For if a utility is so restricted in a determination of its compensation, then, to, must the individual receive the same measure, as in both instances there is a "taking" of their property within the Fourteenth Amendment of the Constitution of the United States. *West v. Chesapeake & Potomac Telephone Company, supra.*

The Appellee appreciates the complexity of public utility regulation but while the determination of a fair return on the fair value of a utility's property may be a vexatious one, it is not to be solved by an approach so at variance with fundamental concepts of justice. The problem is a practical one for the regulatory bodies to cope with, and, as has been pointed out, there are many developments in rate regulation which do and will increasingly facilitate their determination of the difficult questions involved.

The real and "practical" solution to the problem has already been provided by this Court. In *Railroad Com-*

mission of California v. Pacific Gas & Electric Company, supra, this Court sustained the action of the Commission in disregarding an estimate of reproduction cost which was too "conjectural" and in fixing rates based on prudent investment. We believe that in so doing this Court in effect announced the rule that only substantial evidence need be considered, that conjectural or speculative evidence may be disregarded and that commissions need not themselves produce evidence of all relevant elements of fair value, but that this burden must be borne by the utility. Such a rule, we submit, is the constitutionally proper solution to the problems stated in the Commission's brief. It is practical, economically sound, and legally just.

But it must never be forgotten that the problem is an administrative problem. The job is the commissions' job. It is the courts' function not to make rates but to see that they are constitutional. We can find no clearer statement of the relationship of the judiciary and the complexity of rate regulation than that made by the Circuit Court of Appeals for the Ninth Circuit in *Puget Sound Power & Light Company v. City of Puyallup,* 51 Fed. (2nd) 688, 690 (1931), where it was said:

> "In view of this situation, it has been determined that the Constitution of the United States prohibiting the taking of property without compensation requires that the owners of a public utility shall not be deprived of a fair return upon the fair value of the property devoted to the public use. In arriving at the fair value of a public utility investment, the courts have gradually evolved rules with relation to the evidence pertinent to that issue. These rules which indicate the nature and character of the evidence to be considered by the rate-making

body and by the courts in determining the fair value of a public utility property are largely prohibitive in character; that is to say, *the courts have determined that rates cannot be fixed upon a basis which ignores certain elements of value which go to make up a fair value of the property.* This process of evolving an appropriate method of valuation for rate-making purposes is still in a state of development, and involves very great practical difficulties, some of which are not completely solved, partly for the reason that under the Constitution final authoritative decision rests in the courts which have no power to make rates and no machinery for the ascertainment of all of the complex elements entering into the determination of what constitutes a fair valuation of the property. The province of the court in such a matter is confined to the duty of preserving to the owner of property the fundamental right guaranteed to him by the Constitution that his property shall not be taken from him without just compensation, and for that purpose to prohibit the nibbling away of his property by the fixing of rates which gradually but effectively destroy the value thereof."

The Appellee submits that the request of the Commission that this Court repudiate the doctrine of *Smyth v. mes* should be refused as repugnant to common sense nd to a proper regard for the rights guaranteed by the onstitution of the United States.

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